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14 December 2015

Legislative Council Secretariat
Legislative Council Complex
1 Legislative Council Road
Central
Hong Kong
(Attn: Mr. Jason KONG)

Dear Mr. KONG,

**Legislative Council
Establishment Subcommittee**

**Follow-up action arising from the discussion
at the meeting on 2 December 2015
EC(2015-16)9**

Regarding the matters to be followed up on EC(2015-16)9 relating to the Hong Kong section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link (“XRL”) project raised by Members at the Establishment Subcommittee (“ESC”) meeting on 2 December 2015, our reply is as follows –

Item (a)

Since the MTR Corporation Limited’s (“MTRCL’s”) announcement of the project delay of the XRL project in April 2014, the Transport and Housing Bureau (“THB”) and Highways Department (“HyD”) have taken steps to improve and enhance

the project governance, reporting and communications framework with a view to ensuring the MTRCL to complete the XRL project according to the revised programme and budget as follows:

Transport and Housing Bureau

As far as the corporation governance is concerned, the Government continues to proactively carry out its duties as MTRCL's majority shareholder. MTRCL announced on 21 August 2014 the establishment of two new committees under the Board of MTRCL, namely the Capital Works Committee and Risk Committee. These two new committees will facilitate more in-depth and focused monitoring of construction progress and overall risk management of MTRCL (including railway service, maintenance and repair). Subsequently, MTRCL announced on 14 October 2014 the appointment of four new Directors, including one Government Director and three independent non-executive Directors. These four newly appointed directors who have different professional backgrounds, including engineering, accounting, auditing and public administration, have enabled more diversification of background, experience and professional knowledge of MTRCL's Board Members. It is expected that this would strengthen the MTRCL's corporate governance and operation.

Highways Department

The dedicated division for XRL project under the Railway Development Office ("RDO") has implemented the following measures to enhance monitoring following the recommendations by the Independent Expert Panel and based upon past experiences –

- (i) since April 2014, the number of staff in the dedicated division for the XRL project under RDO has increased from 13 to 18 at present. The current staff set-up includes one Chief Engineer, six Senior Engineers, ten Engineers and one Assistant Engineer;
- (ii) submit monthly progress reports to THB for the XRL project with the adoption of "traffic light" system to facilitate THB's understanding of current project status;
- (iii) request the MTRCL to submit detailed reports on critical construction activities including the production rates of critical contracts;

- (iv) monitor the achievement of milestones established by the MTRCL's Independent Board Committee through the monthly progress reports and the Project Supervision Committee meetings chaired by the Director of Highways;
- (v) liaise more closely with the MTRCL's project team and request the MTRCL to provide more detailed information;
- (vi) arrange the Monitoring and Verification ("M&V") Consultant to attend the Project Supervision Committee meetings;
- (vii) establish a working group amongst HyD, M&V Consultant and MTRCL with members from the respective specialised teams to review the programme and progress of the XRL project in details on a regular basis with all aspects and level of works covered; and
- (viii) arrange the M&V Consultant to conduct more frequent and focus audits on critical contracts.

The planning and implementation of the above enhanced monitoring measures were led by the Chief Engineer of the dedicated division for XRL project. If the proposed CE/RD2-3 is approved by LegCo, CE/RD2-3 will continue to vigilantly take forward these measures and lead the dedicated team in the Highways Department to see to the completion of the XRL project as early as possible and within the revised budget.

Item (b)

The information on the position of claims made by contractors of the XRL project has been included in the quarterly report for the period ending 30 September 2015 submitted to LegCo Subcommittee on Matters Relating to Railways (No. CB(4)280/15-16(01)). The relevant information is extracted as follows:

As at 30 September 2015, the MTRCL received 852 substantiated claims and the amount claimed in total was approximately \$26.21 billion. As at 30 September 2015, 130 cases were resolved and about \$1.471 billion was awarded. Subject to the needs of individual works and progress of the relevant assessment and discussion, interim award amounting to about \$4.002 billion have been made for some cases.

Item (c)

Temporary Suspension/Termination of Project

As explained in the LegCo paper no. CB(4)280/15-16(02) and supplementary information paper no. CB(4)333/15-16(02) submitted to the RSC on 30 November and 11 December respectively this year, if the XRL contracts were suspended or even terminated, there would be additional expenditure incurred to the project including costs for –

- (a) settlement of contractors' claims;
- (b) upkeep of essential staff and plants on site as well as arranging regular maintenance and inspection for the unfinished works during suspension period;
- (c) securing and protecting the unfinished works, tunnel and works sites, upkeep of the temporary traffic management scheme and monitoring of ground water to address safety concerns; and
- (d) termination of all employment contracts, cancelling works subcontracts, compensation of rental agreements and demobilisation of plants.

If the application for additional funding for the XRL project cannot be approved by LegCo Finance Committee by end February 2016, as a responsible project manager, the MTRCL may need to issue a suspension notice to its contractors in order to keep the total cost (including suspension costs) within the amount allocated by the Government, i.e. \$65 billion. The MTRCL assessed that the suspension cost would be about **\$0.233 billion per month**. If so, with each month passing from end-February 2016, instead of spending money on constructing the XRL, the money would be spent on suspension-related items. The XRL contracts between MTRCL and the contractors allow for a suspension period of a maximum of 180 days (about six months). If the XRL contracts are subsequently terminated after the 180 days of suspension, there will be another lump-sum cost to terminate including settlement of historical claims and costs of protecting the works at about **\$3.4 billion**. The total additional cost incurred above could therefore be in the region of **\$4.8 billion (i.e. \$0.233 billion x 6 months + \$3.4 billion)**. The M&V Consultant advises the Highways Department that this estimation of additional cost incurred is reasonable. MTRCL also points out that should the works be suspended or terminated, the contractors may take a different view as to their entitlements for the cost of works completed, which would lead to a lot of disputes and a much higher additional cost to the XRL project. The M&V Consultant concurs with this view.

Resumption after Termination

If the existing XRL contracts were terminated, it might take two to three years before the contracts could be resumed because new tenders would have to be invited to engage new contractors to finish the remaining works. During the interim, it might be sufficient to provide minimum protection to the unfinished works. Under this scenario, the MTRCL (assuming that the Corporation will remain as the Project Manager) would need to arrange new contractors to proceed with the outstanding works. The construction costs would likely further escalate due to the possible increase in labour and material costs. Furthermore, due to increase in difficulty and risk to the new contractors to work on the unfinished works, the returned tender price would likely be much higher. Together with the additional costs for design review, project management, insurance and maintenance of the existing works during the waiting period, M&V Consultant estimates, as a ballpark figure, that the resumption cost until completion of the project could be up to \$28.2 billion. Together with the cost for suspension/termination of \$4.8 billion, the cost estimated to be incurred under this scenario is about **\$33 billion**.

Abandonment of XRL Project

If the XRL project were abandoned, the designs and the unfinished works of the XRL project would become **abortive**. It should also be noted that the additional expenditure of \$4.8 billion as referred above assumes that the XRL project would eventually be resumed within two to three years after suspension or termination of existing XRL contracts. Hence, only minimum amount of protection, such as temporary stabilisation would be provided to the unfinished works. Part of the works will still rest on temporary supports, and temporary roads would be maintained as their current status and would not be reinstated immediately.

However, if the XRL project were abandoned, **the Entrustment Cost of \$65 billion would be wasted**. The Government would still need to complete most of the remaining works, including the remaining short section of railway tunnel, most of the civil and structural works at West Kowloon Terminus (“WKT”) (including excavation works, structural columns, slabs within the Terminus and the rooftop) and the permanent road network around WKT (including the road tunnel at Lin Cheung Road and Austin Road and the road network around Jordan Road) in order to ensure that the safety of the public would not be compromised and people would not suffer from a long-term traffic inconvenience. A very rough estimate by the M&V Consultant is

that the cost for completing these essential works would be no less than **\$10.6 billion**. Furthermore, Government would need to continue maintaining these works until there is a new initiative for their use. Rough estimates of the maintenance cost could be as much as **\$0.1 billion** per year. Separate approval from LegCo would have to be sought for the above additional amounts of money. Together with the loss of Entrustment Cost of \$65 billion (which includes the cost for suspension/termination of \$4.8 billion), the total cost estimated to be incurred under this scenario is at least **\$75.6 billion**.

In gist, in the event of project suspension or even termination, there is still a need to create the proposed Chief Engineer post. In such case, the major duties of the proposed Chief Engineer will include the following:

- (i) handling the direct claims from the contractors;
- (ii) planning and implementing measures to ensure the safety of works sites and upkeeping of temporary traffic arrangements;
- (iii) planning and implementing measures to upkeep the unfinished works and facilities;
- (iv) coordinating with other departments and authorities to mitigate the impacts of project suspension to the surrounding development projects, such as West Kowloon Cultural District Development;
- (v) planning the follow-up actions upon project suspension to cater for different situations, including the reinstatement of temporary traffic arrangements, resumption of works after project suspension, termination of project etc., and apply for supplementary funding as needed; and
- (vi) handling the liability issues under the Entrustment Agreements with MTRCL for the XRL project.

The above duties involve heavy workload and have no precedent cases for reference. The workload and complexity of these duties may even be greater than the original duties for monitoring of the XRL project, depending on which follow-up action is adopted. Currently, we envisage that it may take quite considerable time to complete the above duties.

Given that the XRL project is a public works project, the Government has to seek approval from the LegCo FC for the additional amount required to complete the project. Whether or not the XRL Agreement signed between the Government and MTRCL on 30 November 2015 is approved by the independent shareholders of MTRCL is a separate matter from the funding application.

Item (d)

On 26 January 2010, the Government and the MTRCL entered into an *Entrustment Agreement for Construction and Commissioning of the Express Rail Link* (“EA2”). Earlier on 24 November 2008, the Government and the Corporation entered into an *Entrustment Agreement for Design and Site Investigation in relation to the Express Rail Link* (“EA1”).

Given these two documents are confidential in nature and their contents involve sensitive commercial information, the EA1 and EA2 are for the internal reference of Government and the MTRCL only (i.e. the two contractual parties of the EA1 and EA2). We are prepared to provide the EA1 and EA2 (with very minimal redactions) to the ESC on a confidential basis, i.e. the EA1 and EA2 are to be classified as confidential and are to be provided in confidence for use by the ESC members at closed meetings.

Yours sincerely,



(Chris NG)

for Secretary for Transport and Housing

c.c.

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