

立法會
Legislative Council

LC Paper No. FC226/17-18

(These minutes have been
seen by the Administration)

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Finance Committee of the Legislative Council

**Minutes of the 58th meeting
held at Conference Room 1 of the Legislative Council Complex
on Friday, 7 July 2017, at 4:40 pm**

Members present:

Hon CHAN Kin-por, GBS, JP (Chairman)
Hon Michael TIEN Puk-sun, BBS, JP (Deputy Chairman)
Hon James TO Kun-sun
Hon LEUNG Yiu-chung
Hon Abraham SHEK Lai-him, GBS, JP
Hon Tommy CHEUNG Yu-yan, GBS, JP
Prof Hon Joseph LEE Kok-long, SBS, JP
Hon Jeffrey LAM Kin-fung, GBS, JP
Hon WONG Ting-kwong, GBS, JP
Hon Starry LEE Wai-king, SBS, JP
Hon CHAN Hak-kan, BBS, JP
Dr Hon Priscilla LEUNG Mei-fun, SBS, JP
Hon WONG Kwok-kin, SBS, JP
Hon Mrs Regina IP LAU Suk-yee, GBS, JP
Hon Paul TSE Wai-chun, JP
Hon LEUNG Kwok-hung
Hon Claudia MO
Hon Steven HO Chun-yin, BBS
Hon Frankie YICK Chi-ming, SBS, JP
Hon WU Chi-wai, MH
Hon YIU Si-wing, BBS
Hon MA Fung-kwok, SBS, JP
Hon Charles Peter MOK, JP
Hon CHAN Chi-chuen

Hon CHAN Han-pan, JP
Hon LEUNG Che-cheung, SBS, MH, JP
Hon Kenneth LEUNG
Hon Alice MAK Mei-kuen, BBS, JP
Dr Hon KWOK Ka-ki
Hon KWOK Wai-keung, JP
Hon Dennis KWOK Wing-hang
Hon Christopher CHEUNG Wah-fung, SBS, JP
Dr Hon Fernando CHEUNG Chiu-hung
Dr Hon Helena WONG Pik-wan
Hon IP Kin-yuen
Dr Hon Elizabeth QUAT, BBS, JP
Hon Martin LIAO Cheung-kong, SBS, JP
Hon POON Siu-ping, BBS, MH
Dr Hon CHIANG Lai-wan, JP
Ir Dr Hon LO Wai-kwok, SBS, MH, JP
Hon CHUNG Kwok-pan
Hon Alvin YEUNG
Hon Andrew WAN Siu-kin
Hon CHU Hoi-dick
Hon Jimmy NG Wing-ka, JP
Hon LAM Cheuk-ting
Hon Holden CHOW Ho-ding
Hon SHIU Ka-fai
Hon SHIU Ka-chun
Hon Wilson OR Chong-shing, MH
Hon YUNG Hoi-yan
Dr Hon Pierre CHAN
Hon CHAN Chun-ying
Hon Tanya CHAN
Hon HUI Chi-fung
Hon LUK Chung-hung
Hon Kenneth LAU Ip-keung, BBS, MH, JP
Dr Hon CHENG Chung-tai
Hon KWONG Chun-yu
Hon Jeremy TAM Man-ho
Hon Nathan LAW Kwun-chung
Dr Hon YIU Chung-yim
Dr Hon LAU Siu-lai

Members absent:

Dr Hon Junius HO Kwan-yiu, JP
Hon HO Kai-ming
Hon CHEUNG Kwok-kwan, JP
Hon LAU Kwok-fan, MH

[According to the Judgment of the Court of First Instance of the High Court on 14 July 2017, LEUNG Kwok-hung, Nathan LAW Kwun-chung, YIU Chung-yim and LAU Siu-lai have been disqualified from assuming the office of a member of the Legislative Council, and have vacated the same since 12 October 2016, and are not entitled to act as a member of the Legislative Council.]

Public officers attending:

Ms Elizabeth TSE Man-ye, JP	Permanent Secretary for Financial Services and the Treasury (Treasury)
Ms Carol YUEN, JP	Deputy Secretary for Financial Services and the Treasury (Treasury) 1
Mr Alfred ZHI Jian-hong	Principal Executive Officer (General), Financial Services and the Treasury Bureau (The Treasury Branch)
Ms Rebecca PUN Ting-ting, JP	Deputy Secretary for Transport and Housing (Transport) 1
Mr Raymond CHENG Nim-tai	Principal Assistant Secretary for Transport and Housing (Transport) 7
Mr Daniel CHUNG Kum-wah, JP	Director of Highways
Mr Jimmy CHAN Pai-ming, JP	Principal Government Engineer (Railway Development), Highways Department
Mr Anthony YUEN Woo-kok	Chief Engineer (Railway Development)1-3, Highways Department

Other persons attending:

Dr Philco WONG	Projects Director, MTR Corporation Limited
Mr Ken WONG	General Manager (Projects), MTR Corporation Limited
Mr Stephen YAU	Manager (Estimates, Cost Control and Logistics), MTR Corporation Limited

Ms Prudence CHAN

Senior Manager (Projects and Property Communications), MTR Corporation Limited

Clerk in attendance:

Ms Anita SIT

Assistant Secretary General 1

Staff in attendance:

Ms Ada LAU

Senior Council Secretary (1)7

Mr Raymond SZETO

Council Secretary (1)5

Miss Queenie LAM

Senior Legislative Assistant (1)2

Mr Frankie WOO

Senior Legislative Assistant (1)3

Miss Yannes HO

Legislative Assistant (1)6

Action

Item No. 1 — FCR(2017-18)13

**RECOMMENDATION OF THE PUBLIC WORKS
SUBCOMMITTEE MADE ON 20 APRIL 2017**

PWSC(2016-17)44

HEAD 706 — HIGHWAYS

Transport — Railways

**56TR — South Island Line (East)—essential public infrastructure
works**

The Chairman reminded members of the requirements under Rule 83A and Rule 84 of the Rules of Procedure, and declared that he was an independent non-executive director of The Bank of East Asia.

2. The Chairman said that this item sought approval from the Finance Committee ("FC") for increasing the approved project estimate ("APE") of 56TR, i.e. essential public infrastructure works ("EPIW") for the South Island Line (East) ("SIL(E)"), by \$286.2 million from \$927 million to \$1,213.2 million in money-of-the-day ("MOD") prices. This item had been discussed by the Public Works Subcommittee ("PWSC") at three meetings for five hours, and by FC at its meeting held on 23 June 2017 for one hour and 49 minutes.

Members' views on the meeting arrangements for the day

3. Mr Andrew WAN, Mr James TO, Dr KWOK Ka-ki and Mr Nathan LAW asked the Chairman about the House Committee ("HC") and FC meeting arrangements for the day, and questioned the appropriateness of such arrangements.

4. At the direction of the Chairman, Clerk to FC explained to members the relevant provisions in the House Rules and the FC meeting arrangements for the day, including the contents in the relevant circulars. The Chairman said that it would be up to the HC Chairman to decide whether HC would, after the end of this FC meeting, resume its meeting to deal with any unfinished business. The Chairman further said that having regard to HC's meeting arrangements, the two FC meetings originally scheduled for the day had been reduced to one, as he considered it reasonable to facilitate members' attendance at the welcome banquet held in honour of the visiting President of the State. He also indicated that the meeting arrangements had nothing to do with the invitation received by some members to visit the aircraft carrier Liaoning on the late afternoon of the day.

5. Mr WONG Ting-kwong and Ms Alice MAK criticized that the wording used by some members in their speeches was not appropriate.

Calculation and presentation of the breakdown of cost overruns incurred by the essential public infrastructure works

6. Regarding the Administration's claim that the on-cost payable to the MTR Corporation Limited ("MTRCL") had increased by \$29.1 million, Mr CHU Hoi-dick queried that the figure was calculated in September 2010 prices, not reflecting the actual payable amount as calculated in MOD prices. Mr CHU sought information on the increase in the on-cost payable to MTRCL by the Administration.

7. Dr YIU Chung-yim noted that according to LC Paper No. PWSC178/16-17(01), the on-cost payable to MTRCL represented 16.5% of the project base cost, which was inconsistent with the calculation set out in Annex 1 to LC Paper No. FC218/16-17(01). He demanded an explanation from the Administration for such difference. Dr YIU also requested a breakdown of the provision for price adjustments, including the amount used on paying claims and that on design changes, so that members could have a better idea about how the on-cost was used. Ms Claudia MO was of the view that the Administration had failed to give a clear account of how the cost overruns incurred by various items in EPIW were calculated.

8. The Deputy Secretary for Transport and Housing (Transport) 1 ("DSTH(T)1") responded that most of the EPIW projects were carried out under target-cost contracts where major claims arising from unforeseeable factors and extended construction periods were settled by way of reimbursement based on the actual expenses incurred by the contractors concerned during the construction period. Column (C) of Annex 1 set out the actual project expenses broken down by different items. In fact, the actual expenses concerned were presented in MOD prices, and were made up of the constant price (i.e. \$985.7 million presented in September 2010 prices) and provision for price adjustments (i.e. \$227.5 million). The actual project costs (i.e. \$1213.2 million presented in MOD prices as set out in Column (C) of Annex 1) included the corresponding provision for price adjustment as estimated in the funding proposal submitted in 2011.

[*Post-meeting note:* The Chinese version of the supplementary information provided by the Administration was issued to members vide LC Paper No. FC224/16-17(01) on 13 July 2017.]

Supervising the essential public infrastructure works

The relationship between MTRCL and its contractors

9. Referring to the relevant listing documents, Mr CHAN Chi-chuen advised that among the contractors carrying out works for project 56TR, Leighton Contractors (Asia) Limited ("LCAL") of Contract 903 and John Holland Party Limited ("JHL") of Contract 904, as well as their parent companies, were MTRCL's business partners. Pointing out that the projects involving cost overruns under this agenda item were the works specified in Contract 903, Mr CHAN expressed concern about the close relationship between MTRCL and its contractors. He considered that the Administration should question the impartiality and independence of MTRCL in supervising these contractors. Pointing out that while the Government had to pay a large sum of management fees to MTRCL for supervising outsourced works on the Government's behalf on the one hand, the work of MTRCL was subject to the supervision of the Government itself on the other, Mr LEUNG Yiu-chung criticized that this would only lead to duplication, redundancy and ineffectiveness.

10. Mr CHAN Chi-chuen requested the Administration to provide information on cost overruns under the present EPIW broken down by items under Contract 903 and Contract 904, as well as the reasons for taking as long as three years to pay the overrun costs. Citing provisions in Contract 903 signed between MTRCL and LCAL, Mr CHAN said that regarding limitations of liability of LCAL, "[t]he total liability of LCAL to the Company (i.e. MTRCL) for all damages (liquidated damages and general) for delay shall not exceed 10% of the target cost plus fees as calculated under the Contract". He asked whether this provision on limitations of liability had ever been triggered.

11. In response, Projects Director, MTR Corporation Limited ("PD/MTRCL") said that:

- (a) it was common that a tendering party and a tenderer had business links other than the project being tendered. Regarding EPIW, the relationship between MTRCL and its contractors were set out clearly in the tender document. Apart from clearly setting out in the contract the areas of work and limitations of liability of the contractor, MTRCL had also put in place a sound monitoring regime under which a Project Supervision Committee ("PSC") comprising MTR professionals and the Government's monitoring and verification ("M&V") consultant was set up to examine whether the claims made under the project were sufficiently justified and whether such claims should be approved;
- (b) apart from the items of "Footbridge link to Ap Lei Chau Estate" and "Junction improvement at Ap Lei Chau Drive and Ap Lei Chau Bridge Road", which were works under Contract 904, all other items were works under Contract 903. Given that most EPIW items were awarded under target-cost contracts, it was necessary to provide sufficient time for sub-contractors to consolidate and submit information relating to actual expenses, in order to derive the actual cost overruns that had been incurred; and
- (c) Contract 903 was a target-cost contract under which major claims arising from unforeseeable factors and extended construction periods were settled by way of reimbursement based on the actual expenses incurred by the contractors concerned during the construction period. If the contractor was the party to be held responsible for the delay, the total

liability of the contractor to the MTRCL for all damages (liquidated damages and general) for delay should not exceed 10% of the sum of the target cost plus fees as calculated under the Contract.

Cost overruns relating to ground investigations

12. Mr CHAN Chi-chuen and Dr LAU Siu-lai asked whether MTRCL had consulted the Administration prior to its decision of not carrying out ground investigations at Wong Chuk Hang Nullah. Given that unfavourable ground conditions were subsequently identified and works progress was delayed as a result, they also enquired about the party to be held responsible for such delay. Ms Claudia MO asked whether unfavourable ground conditions and layout of underground utilities constituted force majeure events upon which claims could be made.

13. Regarding MTRCL's claim that the excavation of trial pits was inevitably restrained by certain limitations, Mr LEUNG Yiu-chung considered that MTRCL had failed to comply with the requirements in the Entrustment Agreement entered into between MTRCL and the Government, i.e. works were required to measure up to the reasonable expectations of professional engineers.

14. The responses of the Administration and MTRCL were as follows:

- (a) General Manager (Projects), MTR Corporation Limited ("GM/MTRCL") replied that MTRCL had liaised with the Drainage Services Department ("DSD") in respect of the ground investigations to be carried out at Wong Chuk Hang Nullah, and was given to know that according to DSD's request, the works so carried out should not reduce the flood discharge capacity of the Nullah. MTRCL considered that as the ground investigations, if carried out, would have to proceed after the rainy season, which meant a delay in inviting and awarding the tender for EPIW, the completion schedule for EPIW would be procrastinated and inconvenience would be caused to members of the public during the initial commissioning of SIL(E). Based on the above considerations, MTRCL did not carry out ground investigations in the Nullah;

- (b) the Director of Highways ("DHy") responded that the Government entered into an agreement with MTRCL to entrust the design and construction of EPIW to MTRCL, and under the agreement, MTRCL was required to be held responsible for its decisions in respect of these works. According to arrangements under the Entrustment Agreement, if a decision made by MTRCL regarding EPIW might have the effect of increasing government expenditure, it was incumbent upon MTRCL that the Government be consulted and notified before such decisions were made. If MTRCL contravened what had been laid down in the Entrustment Agreement, the Government might seek to recover losses from MTRCL on the ground of MTRCL going against the Entrustment Agreement;
- (c) moreover, the excavation of trial pits was subjected to various objective factors such as the works area, environmental and road traffic situations, land use situation and the works timeframe. To comply with the requirements under the Entrustment Agreement, MTRCL had collected information from various public utility companies and relevant government departments about the underground utilities within the works area which might be affected by the works. In parallel, MTRCL had, wherever possible, made use of trial trenches/pits to verify the accuracy of the utilities records and the locations of underground utilities. So far, the Government had not identified any non-compliance with the Entrustment Agreement on the part of MTRCL;
- (d) GM/MTRCL added that at the design stage, MTRCL followed the Geoguide compiled by the Geotechnical Engineering Office to carry out ground investigations, with the total number of drill holes exceeding that recommended by the Geoguide. However, it was difficult to foresee the distribution of large boulders underneath the Nullah; and
- (e) PD/MTRCL said that unfavourable ground conditions or the layout of underground utilities did not constitute force majeure events upon which claims could be made.

15. Dr Fernando CHEUNG and the Chairman expressed concern about how the Administration would, in future, forestall the possibility of delays or cost overruns caused to infrastructure works by underground utilities that were more complicated than expected. Considering that the provision for contingencies should be used on additional expenses arising from the need of handling circumstances that were more complicated than expected, Dr Fernando CHEUNG questioned the justifications provided by the Administration for seeking supplementary provision.

16. DHy responded that there had actually been cases where the utilities records provided by utilities companies and relevant government departments did not reflect the actual situation on sites, in particular for early development areas, which had made the situation of underground utilities more complex than expected. Since the implementation of the system of "excavation permits" ("EPs") in April 2004, it was stipulated that after the completion of underground facilities works, the promoter of the excavation works concerned must, in conformity with the requirements set out in EPs, confirm records on the depth and alignment of the underground facilities concerned. The promoter was also required to submit such records to the Highways Department at the request of DHy. The Administration hoped that with the implementation of the EP system, similar situations could be minimized. He also said that the provision for contingencies in the original APE was not sufficient to cover the increase in project costs. The increase was mainly due to unfavourable ground conditions and the underground utilities being more complicated than expected, both of which were identified after the actual construction works had commenced.

Solutions to the problem of cost overruns

17. Dr LAU Siu-lai pointed out that in 2015-2016, it was originally estimated that the cost overrun incurred by the Kwun Tong Line Extension ("KTE") project would be around \$75 million. However, on 30 September 2016, the Administration said that the construction costs could be maintained at the level estimated in 2011. Dr LAU asked whether the present case of cost overruns incurred by EPIW could be handled in the light of the experience learnt from the KTE project.

18. DHy and Senior Manager (Projects and Property Communications), MTR Corporation Limited("SM/MTRCL") responded that MTRCL informed the Administration in August 2015 that a review of the project costs of the KTE project had been completed and according to the review findings, the additional expenditure of the construction cost of Ho Man Tin Station to be shared by the Shatin to Central Link ("SCL") was still within the estimated construction cost of the advance railway works of the SCL. As regards the EPIW of KTE which was entrusted to MTRCL by the Government, further assessment of the construction costs conducted by MTRCL showed that it might exceed APE by about \$75 million, as mentioned by Dr LAU. However, subsequent to the discussion between MTRCL and the relevant contractors, the amount of claims was reduced and the project eventually did not incur cost overruns. The Administration agreed to provide a supplementary paper after the meeting on the handling of payments to MTRCL in respect of EPIW of KTE, which had eventually made it possible for the infrastructure project to be completed within APE. Information would also be provided on whether the cost overruns incurred by the present item could be handled in the same manner as the KTE project.

[Post-meeting note: The Chinese version of the supplementary information provided by the Administration was issued to members vide LC Paper No. FC224/16-17(01) on 13 July 2017.]

"Rail-plus-Property" financing model and financial assistance

19. Pointing out that the Administration had adopted the "Rail-plus-Property" financing model to take forward the SIL(E) project under which MTRCL was given the right to develop properties on top of railway stations, Mr Alvin YEUNG sought the reasons why consideration had not been given to requesting MTRCL to offset the cost overruns incurred by this project with the profits to be generated from topside property development. Ms Claudia MO also raised a similar question.

20. Ms Tanya CHAN considered that while MTRCL was given the right to develop properties on top of railway stations under the "Rail-plus-Property" financing model, the land premium payable by MTRCL to the Government for the relevant property developments was assessed on a green field basis (i.e. ignoring the presence of railway). Despite the colossal profits that could be generated by railway development, MTRCL had refused to construct road transport links connecting SIL(E) stations with areas in the vicinity of MTR stations. She enquired about the risks that MTRCL had to bear under the "Rail-plus-Property" financing model.

21. The Deputy Secretary for Transport and Housing (Transport) 1 ("DS(T)1") replied that:

- (a) the nature of the SIL(E) project was different from that of the EIPW project;
- (b) the construction cost of the SIL(E) project was such an enormous amount that the project was not considered financially viable based on their fare and non-fare revenues alone. As such, the Government granted the topside property development rights to MTRCL under the "Rail-plus-Property" financing model to bridge the funding gap of the project with caution that the land to be granted to MTRCL should not be more than what was required to bridge the funding gap. Under this financing model, MTRCL had to bear long-term risks in financing the SIL(E) project, property market fluctuations and railway operation responsibilities while the Government was spared. As a result, although the construction cost of the SIL(E) project had exceeded APE by \$3.4 billion in MOD prices, the Government had been spared from the relevant additional expenses; and
- (c) EPIW was a public works project. The Government had to shoulder the expenses incurred by the project, while the design and construction of EPIW were entrusted to MTRCL to ensure better coordination between the aforesaid EPIW and the SIL(E) project, thereby enabling the early commissioning of the facilities for public use.

22. Noting that under the "Rail-plus-Property" financing model, MTRCL would pay full market premium on a green field basis in respect of property development (i.e. ignoring the presence of railway in assessing the land premium), Dr Fernando CHEUNG requested the Administration or MTRCL to provide information on the difference between the market premium calculated on a green field basis and the premium that was assessed by taking into account the presence of railway (including the SIL(E) project and its associated EPIW), as well as the expected return on capital for SIL(E) (including the weighted average cost of capital and its rate of increase). Ms Tanya CHAN also asked whether the Administration would review its policy on land premium.

23. The responses of the Administration and MTRCL were as follows:

- (a) DS(T)1 responded that the "Rail-plus-Property" financing model was adopted in taking forward the SIL(E) project, and the land premium involved was irrelevant to the EPIW in the present funding proposal; and
- (b) SM/MTRCL added that information on land premium was commercially sensitive information which could not be provided by MTRCL.

[Post-meeting note: The Chinese version of the supplementary information provided by the Administration was issued to members vide LC Paper No. FC224/16-17(01) on 13 July 2017.]

24. The meeting ended at 6:30 pm.

Legislative Council Secretariat

12 April 2018