

Bills Committee on Mass Transit Railway Bill

Unbundling of Mass Transit Railway Corporation

PURPOSE

At its meeting on 11 November 1999, Members of the Bills Committee on the Mass Transit Railway Bill have asked the Administration to provide information on whether the Mass Transit Railway Corporation should be unbundled into two components, i.e. railway infrastructure the ownership of which should be retained by the Government, and passenger services operation, which should be privatized. This paper serves to set out the views of the Government on the issue.

BACKGROUND AND ARGUMENT

Approach to Privatization

2. With the assistance of our financial consultant, we have researched extensively into the different approaches adopted by overseas countries in the privatization of railways. The various methods and techniques adopted by overseas countries are typically employed to transform inefficient and loss-making railways. As such, overseas privatization models and techniques can only be of limited relevance to the case of MTR which is one of the most efficient railways in the world.

Privatization of MTRC as an Integrated Going Concern

3. One of the key issues that we have examined is whether MTRC should be unbundled for the purpose of privatization. Some overseas railway systems have been privatized by breaking up the network either into regional sectors, or by vertical segregation of the system into passenger service operators and rail infrastructure providers (see **Annex**). Such unbundling of assets attempts to instil an element of competition to enhance

the efficiency of loss-making, inefficient railway operations, or to separate inherently unprofitable parts of a particular system.

4. MTRC has a highly successful track record of operating a compact, fully-integrated system and achieving world-class service standards. We have assessed the benefits and disadvantages of unbundling MTRC in the privatization exercise and come to the view that this approach is inappropriate for the following reasons :-

- (a) MTR is unique in being one of the most efficient metro systems in the world. Its highly successful record is attributable to the system being operated as an integrated whole. Breaking up MTRC could jeopardize the provision of a seamless service to passengers and could be counter-productive in promoting efficiency in service delivery;
- (b) from the perspective of the Government as the regulator, it will be desirable for MTRC to remain as an integrated whole so that it can be held responsible for delivering the high service standards that we will expect of the privatized entity. Overseas experience suggests that passenger service operators and infrastructure providers tend to shift the blame to each other whenever there is a service disruption;
- (c) the MTR system is now operating at optimal capacity with the busiest part of the railway having a headway of only two minutes during peak hours. There is hardly any room on the already crowded tracks to accommodate another rail operator.

The separation of service operation from infrastructure provision would result in decreased efficiencies; and

- (d) one of the objectives of the privatization exercise is to realize the commercial value of Government's shareholding in MTRC. Investors may not be keen to invest in an assortment of smaller rail companies. Unbundling may negatively affect the valuation of MTRC and the financial proceeds the Government will get from the sale of the stock. We consider privatization on an "as-is" basis will help achieve the best financial results from the privatization exercise.

Unbundling Experience in UK

5. We do not have comprehensive information on all the railways which have been unbundled in the process of privatization. Reference can nevertheless be taken from the UK case which is more well documented. In the UK, the former British Rail was split into more than 100 companies including an infrastructure company, 25 passenger services operators and three rolling stock companies.

6. Unbundling in UK has not been a complete success. UK's fragmented railway system has been criticized for failing to deliver a seamless service. The separation of passenger service and the provision of railway infrastructure has diluted accountability of individual operators. Passenger service operators and the infrastructure provider tend to shift blame to each other whenever there is a service disruption. The unbundling of UK rail assets has also resulted in insufficient long term capital investment for maintaining and upgrading the railway system.

7. The UK Department of the Environment, Transport & Regions published on 16 September 1998 a policy document (“A New Deal for the Railway”) which identified the following major flaws of the unbundled UK railway system :-

- (a) there is no focus within the privatised industry for long term strategic planning and capital investment;
- (b) in addition to structural flaws, the performance of the passenger train operating companies has been woefully unacceptable. Too many trains are cancelled or running late. About half of the operators have recorded declining punctuality;
- (c) there were nearly one million complaints directed against train operators in 1997/98. Even the Rail Regulator admitted that the figure understated the full picture of passenger dissatisfaction; and
- (d) privatization was supposed to secure seamless service on a network operated by a number of competing railway operators. The fragmented railway has failed to achieve the objective.

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Transport Bureau
16 November 1999

	Railway/Country	Franchise Coverage
Unbundled Railways	Passenger Rail Service/UK	25 Passenger service franchises 3 Rolling stock companies 1 infrastructure company
	Buenos Aires Metro/ Argentina	Passenger service only Rolling stock and tracks belong to the Government
	Rio de Janeiro/Brazil	Passenger service only Rolling stock and tracks owned by government
Integrated Railways	Mexico	Owens and operates rail systems
	East Japan Railway, West Japan Railway and Japan Railway Central	Owens and operates the major railway systems