立法會
Legislative Council

LC Paper No. CB(1)2082/01-02
(These minutes have been seen by the Administration)

Ref: CB1/PS/2/00/1

Legislative Council
Panel on Transport

Subcommittee on matters relating to the implementation of railway development projects

Minutes of meeting on
Thursday, 28 February 2002, at 4:30 pm
in the Chamber of the Legislative Council Building

Members present	**:**	Hon Miriam LAU Kin-yee, JP (Chairman) Ir Dr Hon Raymond HO Chung-tai, JP Hon CHAN Kwok-keung Hon LAU Kong-wah Hon Andrew CHENG Kar-foo Hon TAM Yiu-chung, GBS, JP Hon Abraham SHEK Lai-him, JP Hon Tommy CHEUNG Yu-yan, JP Hon Albert CHAN Wai-yip Hon LEUNG Fu-wah, MH, JP Hon WONG Sing-chi Hon LAU Ping-cheung
Member absent	**:**	Hon LAU Chin-shek, JP
Non-Subcommittee members attending	**:**	Dr Hon CHU Yu-lin, David, JP Hon Eric LI Ka-cheung, JP Hon CHAN Yuen-han, JP Dr Hon LUI Ming-wah, JP Hon IP Kwok-him, JP

Public officers attending	:	Transport Bureau Mr Nicholas NG Secretary for Transport Mr Arthur HO Deputy Secretary for Transport
Attendance by invitation	:	Kowloon-Canton Railway Corporation (KCRC) Mr Michael TIEN Chairman, KCRC Mr K Y YEUNG Chief Executive Officer, KCRC Mr James BLAKE Senior Director, Capital Projects, KCRC Mr Samuel LAI Senior Director, Finance & Management, KCRC Mr David FLEMING Company Secretary & General Counsel, KCRC Mr Leo MAK General Manager, Railway Systems (Ag), KCRC
Clerk in attendance	:	Mr Andy LAU Chief Assistant Secretary (1)2
Staff in attendance	:	Miss Connie FUNG Assistant Legal Adviser 3 Ms Alice AU Senior Assistant Secretary (1)5

Action

I Confirmation of minutes and matters arising

(LC Paper No. CB(1)1022/01-02 - Minutes of meeting held on 6 December 2001)

The minutes of meeting held on 6 December 2001 were confirmed.

Action

2. The Chairman advised that pursuant to members' decision at the meeting on 6 December 2001, she had sent a letter (LC Paper No. CB(1)620/01-02(01)) to the Secretary for Transport conveying members' views on the tendering arrangement and assessment of the railway corporations' proposals for the Sha Tin to Central Link.

II West Rail project update - contract management

(LC Paper No. CB(1)1197/01-02(01) -	Letter dated 23 February 2002 from the Clerk to the Subcommittee to the Administration following up on Hon LAU Kong-wah's request for relevant KCRC documents in their original form;
LC Paper No. CB(1)1197/01-02(02) -	KCRC's response to Hon LAU Kong-wah's request;
LC Paper No. CB(1)1197/01-02(03) -	Letter dated 26 February 2002 from Hon CHENG Kar-foo to the Chairman of KCRC;
LC Paper No. CB(1)1197/01-02(04) -	KCRC's reply to the letter from Hon CHENG Kar-foo;
LC Paper No. CB(1)1197/01-02(05) -	Information paper on "KCRC Contract Strategy";
LC Paper No. CB(1)1138/01-02(01) -	Information paper provided by the Kowloon-Canton Railway Corporation;
LC Paper No. CB(1)1138/01-02(02) -	A reply from the Chief Executive's Office to the letters from Hon Emily LAU;
LC Paper Nos. CB(1)1140/01-02(01) and (02) -	Letters from Hon Emily LAU to the Chief Executive of the Hong Kong Special Administrative Region on the West Rail Contract DB1500; and
LC Paper No. CB(1)987/01-02(01) -	Information paper provided by the Administration)

3. The Chairman invited members to note the above documents in connection with the Kowloon-Canton Railway Corporation (KCRC)'s handling of the West Rail (WR) telecommunications systems contract (DB-1500) awarded to Siemens Limited (Siemens) and the 27 supplemental agreements (SAs) with contractors for 18 WR

Action

contracts. In particular, she drew members' attention to LC Paper No. CB(1)1138/01-02(01) which set out KCRC's response to the questions and concerns raised by members at the last meeting held on 4 February 2002. She also invited members to note the questions raised by Mr CHENG Kar-foo and the reply given by KCRC (issued vide LC Paper Nos. CB(1)1197/01-02(03) and (04) respectively).

4. The Chairman said that KCRC had requested to address members on three issues before continuing discussion on the matter. Members did not raise any objection.

Provision of KCRC documents in original form

5. Mr Michael TIEN, the Chairman of KCRC, advised that a Steering Committee had been formed under his chairmanship to oversee and guide the KPMG investigation into the Corporation's tender evaluation and contractual performance monitoring systems in connection with the WR DB-1500 contract and 26 other SAs.

6. Regarding Mr LAU Kong-wah's request (LC Paper No. CB(1)1197/01-02(01) refers), the Chairman of KCRC said that at the last Subcommittee meeting, he had undertaken to provide the following KCRC documents for members' information:

(a) the two proposals presented to the KCRC Managing Board in September 2001 for resolving the situation as well as the document which gave the negotiating team the mandate of a maximum payment of $98 million;

(b) the memorandum submitted by the negotiating team after its final visit to Germany in November 2001; and

(c) the report presented to the KCRC Managing Board seeking authorization for the $100 million payment.

However, the legal advice he subsequently obtained was that it would not be appropriate to furnish these documents to the Subcommittee in their original form. Some of the documents requested were Managing Board and Tender Board documents which were commercially sensitive. To release the documents into the public domain would not only prejudice the Corporation's ability to procure contracts in a fair and non-discriminatory manner, but also breach the confidentiality provisions contained in the General Conditions of Contract and Supplemental Agreement. Contractual documents requested by members were likewise subject to the same confidentiality provisions. Furthermore, the matter would also have to be considered in the context of any possible litigation that might arise. As such, he expressed sincere apologies for failing to make these documents available to members.

7. Acknowledging members' grave concern in the matter, the Chairman of KCRC assured members that he had asked the Chief Executive Officer of KCRC (CEO of KCRC) to peruse all the documents requested and would, if asked, confirm that all the

Action

relevant information sought by members had been faithfully and accurately extracted from these documents and presented in the relevant reply to questions (a), (e), (f) and (g) as set out in LC Paper No. CB(1)1138/01-02(01). Those original documents had also been submitted to KPMG, who could testify whether the extracted information was consistent with them. If members were not completely satisfied with the reply given by KCRC, the original documents could be furnished to an independent external auditor for verification.

8. Notwithstanding the explanation given, Mr LAU Kong-wah reiterated his request for the Corporation to provide these documents in their original form to facilitate members' understanding. He considered that for the purpose of maintaining confidentiality, all sensitive commercial information contained in these documents could be deleted before they were made available to members.

9. Ir Dr Raymond HO however considered that in view of possible legal consequences, the matter should be handled carefully. Hence, he would accept the course of action proposed by the Chairman of KCRC. Mr David CHU also opined that Mr LAU's request could be pursued at a later stage if members were not satisfied with the reply given by KCRC. Sharing this view, Mr Tommy CHEUNG expressed appreciation for the Chairman of KCRC's sincerity in co-operating with members. Mr Abraham SHEK also remarked that he would accept KCRC's reply as approved by its Managing Board. Given the views expressed by members at the meeting, the Chairman said that the Subcommittee would not insist on requiring KCRC to provide the said documents in their original form at this stage.

KCRC contract strategy

10. Mr K Y YEUNG, CEO of KCRC, gave members a brief account on the contract strategy of KCRC as set out in LC Paper No. CB(1)1197/01-02(05). He advised that KCRC's contract strategy was founded on best Hong Kong and international practice, particularly those of MTR Corporation Limited and airport core projects, taking into account the findings and recommendations set out in the following reports:

(a) Sir Michael LATHAM's Report, Constructing the Team, 1994 (Commissioned by the UK Government);

(b) Sir John EGAN's Report, Rethinking Construction, 1998 (Commissioned by the UK Government); and

(c) The Report of the Construction Industry Review Committee, Construct for Excellence, January 2001, chaired by Mr Henry TANG (Commissioned by the Chief Executive of the Hong Kong Special Administrative Region) (the TANG report).

11. Citing various recommendations made by these reports, CEO of KCRC stressed

Action

that throughout the development of the incidents in connection with contract DB-1500, the decisions made by the Corporation in respect of selection of contractors, allocation of risks and dispute resolution had followed KCRC's contract strategy which was guided by the principles and philosophy enshrined in these authoritative reports.

Selection of contractors

12. On the selection of contractors, CEO of KCRC advised that as stated in the TANG report, "public works contracts are normally awarded to the lowest tenderer provided that he satisfies all other technical requirements" (para. 5.29). As such, after detailed study by the Corporation's technical and financial assessment teams, contract DB-1500 was awarded to Siemens who had submitted the lowest conforming tender.

13. Notwithstanding the explanation given, Ir Dr Raymond HO queried whether KCRC had been duly informed by Siemens about the past performance of the defaulting subcontractor, Optical Network Limited (ONL).

14. In response, Mr James BLAKE, Senior Director, Capital Projects of KCRC (SD/CP, KCRC), advised that the appointment of a specialist subcontractor in late 2000 was considered to be a positive move for recovery of the delay. ONL demonstrated its ability to perform the works to the satisfaction of the Engineer. During 2001, the performance of ONL was subject to continuous review. There had been extensive meetings and teleconferences among KCRC, Siemens and ONL. However, it became clear in July/August 2001 that the commercial issues between ONL and Siemens were preventing progress. Despite the efforts made by the KCRC management team, the promised delay recovery did not materialize and the delay in software design had deteriorated to the point where, unless rapid positive actions were taken, the scheduled opening of WR would have to be delayed. Notwithstanding the position at that time, SD/CP, KCRC stressed that there had not been sufficient justification to re-enter the contract whilst there was always the possibility of improvement and the time available for the delay recovery promises to be put into effect.

15. In reply to Ir Dr Raymond HO's follow-up question, the General Manager, Railway Systems (Ag) of KCRC (GM/RS, KCRC), reported that the three replacement specialist subcontractors were approved by both Siemens and the negotiating team. The new subcontractors all had proven experience in undertaking similar projects either locally in Hong Kong or internationally. In addition, they were able to provide off-the-shelf hardware and standard software requiring minimal customization. Together with the extra manpower and resources pitched in by both Siemens and its specialist subcontractors, the 13-week delay could be recovered within a relatively short period of time. Furthermore, the settlement of all previous claims and variations had also promoted a more harmonious working attitude.

Action

The option to terminate the contract and re-enter

16. Members in general reiterated their grave concerns that the Corporation should have resorted to re-entering the contract instead of negotiating with Siemens for commercial settlement. They considered that as the incident developed, there were clear indications that Siemens should be held responsible for its mistakes. These should constitute sufficient ground for the Corporation to re-enter the contract and sue the contractor for any loss incurred by its delay. In this connection, members considered that the Corporation should look for improvements in the legal aspects of contract procurement as well as contract management.

17. Ir Dr Raymond HO pointed out that if the replacement subcontractors could recover the 13-week delay within a short period of time with the provision of off-the-shelf hardware and standard software, mistakes had clearly been made by Siemens in selecting ONL as the specialist subcontractor in the first place. He further remarked that with repeated warnings given to Siemens and its failure to deliver the promised delay recovery, the Corporation should have sufficient legal basis to terminate the contract on account of Siemens' non-performance and not be afraid of possible counter-claims from Siemens.

18. Mr Albert CHAN considered that in September 2001 when the delay could still be recovered, the Corporation should have terminated the contract with Siemens and get other contractors to take over the work. If the delay was recovered subsequently, the Corporation would have strong reasons to claim Siemens for all its losses, or at least those arising out of the three delayed subsystems. He also queried whether there was inherent fault in the terms and conditions of contract DB-1500 if the contract could not be terminated even when Siemens had clearly failed to perform its contractual obligations and honour its promises to make good the delay. Sharing similar views, Mr WONG Sing-chi opined that KCRC should assume responsibility if the contract did not allow the Corporation reasonable recourse to termination and re-entering. Moreover, he queried the anomaly of setting the first key date in March 2002 because by that time, any delay in the project would be beyond recovery while before that point, the Corporation could not terminate the contract. This was contrary to the statement that back in September 2001, the Corporation was already able to make a firm assessment that there had been a serious delay that could not be overcome unless ONL were replaced. Referring to the possibility of negligence on the Corporation's part in contract preparation, he said that this was an area where improvements should be made.

19. Mr Abraham SHEK however opined that if the contract was re-entered, it might give rise to claims from other contractors and the situation could be even worse. Given the paramount importance for the Corporation to achieve scheduled opening of WR, he considered that the Corporation had acted with public interest in mind and made the best efforts to settle the matter through negotiations with Siemens. For such a mammoth project, it would not be possible to resort to litigation whenever there was a dispute between the Corporation and the contractors.

Action

20. In response, SD/CP, KCRC stated that at law, re-entry or repudiation of the contract with Siemens would have to be a drastic conclusion to a series of events, such as the contractor's refusal to perform according to its obligations. That however was never evident on the part of Siemens as it had all along insisted that the project could still be delivered. Nevertheless, by September/October 2001, there was sufficient evidence that unless some positive action beyond the Contract provision was taken, the delay could not be recovered. This had led to the decision for negotiation. In addition, he pointed out that four out of the seven subsystems under contract DB-1500 were progressing. Should the contract be re-entered, work done on those four subsystems would have been wasted. It might cause further delays which gave rise to possible claims by other civil contractors and railway systems contractors for disruption. SD/CP, KCRC further said that considering the circumstances, re-entry was not an option open to the Corporation in terms of law and project management. Nonetheless, he assured members that a lesson would be learnt so that similar situation could be avoided in future.

21. Responding to members' concerns about the terms and conditions in KCRC contracts for termination, Mr David FLEMING, the Company Secretary & General Counsel of KCRC (CS&GC, KCRC), explained that clear and explicit provisions for termination were in fact provided for in all KCRC contracts. However, there was a procedure which must be followed because termination was a very hard decision to take under any contract. Under the Corporation's procedures, the Engineer was required under clause 46 of the Corporation's General Conditions of Contract for Railway Operations Systems (the General Conditions) to issue a notice to the contractor stating his opinion that the progress of the work was too slow and that the contractor must move ahead if he was to meet the key dates. This step was precursory if the possibility of termination was even contemplated.

22. CS&GC, KCRC further said that for contract DB-1500, two such notices were issued by the Engineer to Siemens in January and August 2001 respectively. However, before reaching the stage of termination under clause 74 of the General Conditions, the Engineer had to determine whether or not he could issue a certificate under clause 46 of the General Conditions to the contractor. He must take into consideration the status of the contractor at that time and whether the contractor had any possible claim on extension of time. At that particular point of time in November 2001, the contractor in fact had such claims on the table and they were not in a position to be disposed of. In addition, the first key date in March 2002 had not yet arisen. Theoretically, there was time for Siemens to make good its delay. That was not uncommon for contracts of this nature when the contractor suddenly realized that the project was lagging behind and a lot of resources was put in to rectify the situation. Hence, the Engineer was faced with a dilemma. First of all, he had extension of time claims potentially on the table. Secondly, he also knew that there was a possibility that the contractor could still meet the key date which was some four to five months away. The Engineer was thus incapable of issuing a certificate. CS&GC, KCRC advised that without this certificate, the Corporation could not

Action

possibly re-enter the contract at that time.

23. The Chairman considered that with the benefit of hindsight, it might help if the contract contained separate milestones for each of the seven subsystems. If the contractor could not meet any of these milestones, the Corporation would have the right to terminate the contract. If that right had been enshrined in the contract, the situation might have been different. In response, SD/CP, KCRC stated that some separate milestones were set under separate cost ends for each system. But the first key date was not due in March 2002. By that time, the situation would have been hopelessly lost. Taking note of members' views and concerns about the legal issues involved, the Chairman of KCRC said that this area would be covered under KPMG's investigation.

24. Responding to Ir Dr Raymond HO's enquiry about the situation with the four progressing subsystems if the contract was re-entered, SD/CP, KCRC stated that the four subsystems would not be completed until the end of the project. Before that, they remained Siemens' intellectual property and the Corporation could not use them if the contract was terminated. He further explained that if the contract was for civil or structural works, it might be possible to take over some partially completed parts in case of re-entering. But for works involving high technology, it would be quite difficult for the replacement contractor to take over and continue with the four partially completed subsystems.

25. To supplement, GM/RS, KCRC said that the final design of the four subsystems had just completed and they were progressing onto the factory production stage. Under the circumstances, there were not many physical parts which the Corporation could take over. He further advised that payment for the four subsystems was made on a monthly basis according to an interim payment schedule. Progress was monitored against the milestones set in the contract.

26. In that case, Ir Dr HO considered that for contracts of high technology items, particular attention should be paid to the additional risks and financial implication involved if the contractor failed to deliver on schedule. Otherwise, any partially completed work that had been paid for might be wasted as it would not be possible for other contractors to step in and take over the work. The Chairman also opined that additional safeguards might be required in respect of payment for contracts of such nature.

27. Mr LAU Ping-cheung said that the technical specifications set out in the tendering document should allow for a certain degree of flexibility enabling the delivery of alternative equivalent systems. GM/RS, KCRC responded that that was exactly the approach adopted by the Corporation. By using a design and build contract, it would allow different contractors the flexibility to design and develop their own systems to meet the required performance specifications.

28. Mr LAU Ping-cheung opined that when tenders were only submitted by three

Action

out of the five pre-qualified companies, the Corporation should have acted in the earliest opportunity to break up the contract into smaller work items as far as practicable and conduct a separate tendering exercise for participation of more companies. As such, he called on the Corporation to review the situation so that a different course of action might be considered under similar circumstances in future.

29. In response, the Chairman of KCRC said that the concerns raised by members in respect of awarding a single contract for related systems were well-taken. However, the problem with contract DB-1500 was that some of the subsystems were progressing well while others were seriously lagging behind, thus adding difficulties to contract administration in respect of the assessment of delay and the ability to terminate the contract, because problems on individual systems could not be isolated. Under the circumstances, the Corporation had to identify and address the drastic options as set out in para. 11 of the reply to question (e), with a view always to ensuring that WR could open on time. He added that given the complicated issues involved, it would not be possible to come up with an easy solution. Subject to the findings of KPMG's investigation, he would pursue the matter in greater detail with the KCRC management team. One option might be to break up related systems into different contracts so that any delay with individual systems could be dealt with separately. Mr LAU Kong-wah cautioned that the additional risk in respect of system integration would have to be taken into account. CEO of KCRC shared Mr LAU's view.

Allocation of risks

30. Advising members on KCRC's contract strategy in respect of allocation of risk, CEO of KCRC said that the form of contract chosen by the Corporation tried to strike an equitable balance of risk between the Corporation and the contractor. This principle was reflected in the TANG report which stated that "in spite of allocation of risks through the contract, any significant default by the contractor remains the client's risk. It is, therefore, in the interest of both parties to adopt contracts based on an equitable allocation of risks" (para. 5.55).

31. Mr TAM Yiu-chung was worried that given the Corporation's prime concern was always to ensure the timely completion of railway projects, this incident might prompt other contractors to make use of the loophole to bid for contracts at low price, and then deploy the same delaying tactics in the hope of getting extra payment for delay recovery measures. He considered that the Corporation should learn from this incident so that similar problems would not happen for future projects. Expressing similar concerns, Mr CHENG Kar-foo put forth the strong view that the existing system of tendering works projects by lump-sum contracts should be reviewed. Coupled with the fact that liquidated damages (LD) was capped at 10% of the contract sum, it had clearly failed to achieve a deterrent effect for those irresponsible contractors. He called on S for T to relay his suggestion to the Secretary for Works for consideration.

Action

32. In reply, the Chairman of KCRC said that generally speaking, he would, from a common sense approach, accept that a contract should be awarded to the lowest conforming tenderer and that the contract should strike an equitable balance of risk between both the Corporation and the contractor. This approach was opposed to putting all risks to the contractors, which would only result in heavy insurance cost to be related back to the employer. In case of claims made by a contractor for extra time and cost, the Corporation would then carefully assess these claims on a case-by-case basis. Contractor's breach of contract would be subject to penalty in the form of LD which was capped at 10% for KCRC contracts. On this mechanism, the Chairman of KCRC further commented that it might not be working satisfactorily if the contract in question was critical to the scheduled opening of the railway and time was running out for delay recovery. Citing the case of contract DB-1500, he said that while it was a relatively small contract costing about $280 million, its delay would have a serious knock-on effect on the whole WR project and result in substantial financial implications for the Corporation. But the 10% LD was clearly not sufficient to cover the loss that might arise. Under the circumstances, the Corporation was put in a very difficult position. One option was to eliminate the liquidated damage, thus putting the contractor liable for general damage and consequently more pressure on him to perform. The obvious drawback was that very few contractors would then be willing to bid under that condition because of the high risk involved, particularly in comparison with the expected revenue.

33. To avoid similar incidents from recurring, the Chairman of KCRC opined that there was clearly a need to put in additional safeguards for such small-scale but critical projects. His initial view was that an earlier completion date should be set for these projects to allow the Corporation leeway to take remedial actions. For this purpose, more milestones should be specified in the contract which would enable the Corporation to terminate the contract and call in other contractors to take over the work at the earliest opportunity. He assured members that as the Chairman of the Corporation, he would review the situation and identify solutions to the problems revealed by the incident.

Dispute resolution

34. CEO of KCRC stated that while the first key date for the three subsystems suffering from delays was March 2002, the Corporation had followed its contract strategy and resorted to negotiation which encouraged early and effective settlement. With the replacement of ONL by three new specialist subcontractors, the contract had, to a certain extent, been re-entered partly. The incident was settled without giving any cause for Siemens to sue the Corporation for terminating the contract.

35. Mr Albert CHAN however opined that the problem was not settled by negotiation, but by compensation. Mr WONG Sing-chi was dissatisfied that by claiming that the problem was resolved through negotiation, CEO of KCRC had downplayed the mistakes made by the KCRC management team in respect of contract preparation and management. Mr David CHU also questioned the passive approach

Action

adopted by the Corporation. He considered that as Siemens was clearly at fault, the Corporation should take legal against Siemens to recover its losses. Ir Dr Raymond HO remarked that the Corporation's decision to send a negotiating team to Germany to engage Siemens in contractual and commercial discussions was not in line with the industry's practice. This might have put the Corporation in a very disadvantageous position during the negotiations.

36. In response, CS&GC, KCRC explained that at the critical point of time in September 2001, the Corporation had a problem on hand. While time was running out and the Corporation would bear serious consequence if no positive action was taken, there were extension of time claims to be resolved which might result in arbitration. Hence, the Corporation was not in a position to determine whether legal actions could be taken against Siemens to recover any monies because the decision as to whether or not Siemens was in fact at fault had yet to be made. He further advised that in common law, there was a duty and obligation for the employer to mitigate any loss he was likely to sustain as a consequence of the contractor's default. The Corporation must therefore make every effort to minimize that loss. Otherwise, if the matter went to arbitration, the Corporation might be questioned for failing to do so.

$98 million negotiation mandate

37. SD/CP, KCRC stated that taking into account the serious delays on contract DB-1500 together with the risk that these delays would pose for WR's timely completion, the KCRC management team came to the conclusion that the best way to resolve the situation, whilst protecting the Corporation's interests, would be to try to reach a commercial settlement with Siemens. To this end, the management team proposed to send a negotiating team to negotiate with Siemens' top management in Germany. The team would endeavour to achieve the following objectives, namely:

(a) removal of a senior person of Siemens from having any influence over contract DB-1500;

(b) the appointment by Siemens of a Project Director and a project management team responsible solely for delivering all of the telecommunications systems to permit WR to open on time;

(c) settle all extant claims and variations up to a current date; and

(d) agree necessary delay recovery measures to meet re-established key dates with LD and interim payment schedules adjusted according to an agreed delay recovery programme.

The proposal to enter into an *ad referendum* negotiations with Siemens subject to a ceiling of $98 million was considered and noted by the KCRC's Managing Board on 19 November 2001.

Action

38. SD/CP, KCRC then referred to the information note on "Build-up of the $98 million negotiation mandate for the DB-1500 supplemental agreement" tabled at the meeting and elaborated on the following three items for settlement under the SA of contract DB-1500:

		$ million
(a)	Value of claims and variations	35.05
(b)	Estimate of amount required to settle claims in dispute	29.90
(c)	Payment for delay recovery of three sub-systems	33.80
	Total	98.75

Regarding item (a), SD/CP, KCRC explained that $35.05 million was the amount cleared with the Engineer before the negotiating team left for Germany. This amount was determined by the Engineer and it covered mostly variations and certain elements of claims which was an entitlement for payment under the contract to Siemens. Two other important issues would also have to be settled during the negotiations, i.e. a number of very substantial claims in dispute and payment for delay recovery of the three subsystems. Detailed calculations of these two items were given in Annexes A and B of the information note.

(*Post-meeting note*: The said information note was subsequently issued to members vide LC Paper No. CB(1)1209/01-02(01).)

39. In reply to Mr LAU Kong-wah, CEO of KCRC confirmed that the $98 million negotiation mandate was worked out carefully by SD/CP, KCRC and his colleagues. No other amount had been considered by the management team.

Estimate of amount required to settle claims in dispute

40. Mr LAU Kong-wah referred to the substantial difference between the Engineer's valuation ($4.7 million) and the amount claimed by Siemens ($146 million) in respect of the estimate of payment required to settle claims under dispute, and queried how the settlement sum of $29.9 million was arrived at. Sharing similar concern, Ir Dr Raymond HO considered that any payment in excess of the Engineer's original valuation was in fact ex-gratia payment to Siemens.

41. In response, SD/CP, KCRC explained that during negotiations, the negotiating team would have to consider the amount claimed by Siemens against the likely outcome of dispute resolution under contract. Notwithstanding the Engineer's

Action

valuation for individual items of claim under dispute, some recognition would have to be given to the amount the Corporation might be required to pay if the contractor's argument gained support in the event of dispute resolution. However, each head of claim was treated slightly differently depending on the basis of the contractor's arguments.

Payment for delay recovery of three subsystems

42. Ir Dr Raymond HO pointed out that according to the practice of the construction industry, the contractor should be responsible for any mistakes in respect of tender price calculations. Hence, he did not agree that 50% payment should be made by KCRC to make up for the difference between the low tender price submitted by Siemens and the "market cost" of carrying out the works which Siemens should have included in its tender. To handle the matter in such as way was blatantly unfair to other tenderers who had entered competitive bids for the contract.

43. While concurring with the view that the Corporation should not compensate Siemens for the consequences of its commercial misjudgment, SD/CP, KCRC explained that the sum of $33.8 million was not paid for Siemens' mistakes in the original contract price. Instead, it was paid for the measures to be taken at that point of time to recover the situation. It was quite clear to the management team that the only effective way to do it within a short span of time was to pay extra money to engage specialist subcontractors who could do the work. He referred to Annex B and said that $173.70 million represented the market cost for the three subsystems, but instead Siemens had proposed $106.10 million, which originally included some savings that Siemens thought it could achieve by taking some of the works of the subsystems in-house, but which obviously did not happen. The difference of $67.60 million was therefore equivalent to the cost of taking on the three new subcontractors to replace ONL. As explained before, the Corporation obviously would not compensate for Siemens' total lost, and therefore had proposed a payment of 50% of the difference, and that equated to $33.80 million. As to the percentage of sharing, it was essentially a matter of judgement.

44. Notwithstanding the Corporation's claim that the cost of terminating the ONL contract fell entirely with Siemens, Mr LAU Kong-wah said that part of the payment was indeed used for that purpose and the calculation was presented in such a way as to rationalize such payment which was totally unjustified.

45. In response, SD/CP, KCRC stressed that the Corporation was not paying Siemens the cost of replacing ONL. The payment was for Siemens to get into place three specialist subcontractors who could get the work done, which the Corporation believed to be the necessary action at that time to recover the situation. However, he acknowledged that from a macro point of view, the Corporation could be seen as paying Siemens to get out of the situation. But the Corporation had no other choice at that time. He assured members that the Corporation would learn from this incident. If Siemens or another contractor came along with a bid like this, the Corporation

Action

would obviously take this experience to heart.

46. Notwithstanding the explanation given, Mr LAU Kong-wah maintained that any payment made to Siemens for delay recovery of the three subsystems was unjustified, bearing in mind Siemens was at fault at the outset. In this connection, he asked whether CEO of KCRC should be held accountable personally. In response, CEO of KCRC said that all the decisions in connection with contract DB-1500 were collective decisions made by the Managing Board and as the then Chairman-cum-Chief Executive of KCRC, he would be accountable to that extent.

47. Mr LAU Kong-wah remarked that similar events were unheard of in public works contracts, and asked whether the Secretary for Transport (S for T), in his role as the overseeing authority, had detected any irregularities in respect of the way contract DB-1500 was handled by the Corporation and raised any objection when the matter was discussed by the KCRC Managing Board.

48. In reply, S for T stated that given the large number of public works items undertaken by the Government, it was inevitable that some would involve delays and non-performance by contractors, the use of negotiation and arbitration to resolve the claims and disputes, termination of contracts, etc. However, if Siemens had been involved in any case of serious breach of contractual obligations, he was certain that such adverse performance would be reported and taken into account at the tender assessment stage. As regards the decisions made by the KCRC Managing Board, S for T reported that in November 2001, the Board noted the management team's intention to enter *ad referendum* negotiations with Siemens in Germany. Subsequent to the negotiations, a paper was put to the Managing Board on 17 December 2001, proposing a SA with Siemens in the sum of $100 million. Having carefully considered all relevant factors, the Board collectively came to the reluctant decision that a commercial settlement with Siemens represented the best possible way out at that moment.

III Any other business

49. Members agreed that another meeting would be held on 4 March 2002, at 8:30 am to continue discussion with the Administration and KCRC.

50. There being no other business, the meeting ended at 6:45 pm.

Legislative Council Secretariat
26 June 2002