Submissions to the Bills Committee on Rail Merger Bill

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1	• The Real Estate Developers Association of Hong Kong • Dr LI Kui-wai, Associate Professor, City University of Hong Kong • Integrated Rail-Property Development Study Team, The Hong Kong Polytechnic University ("The Study Team")	General issues of the rail merger	The Real Estate Developers Association of Hong Kong supports the rail merger as it believes that the rail merger, if properly implemented, will enhance efficiencies and eliminate duplication of resources. This will bring benefits to Hong Kong as a whole. Dr LI Kui-wai, Associate Professor, City University of Hong Kong considered that: The merger will allow the MTR Corporation Limited ("MTRCL") to diversify its investment in three areas: 1. the planning of railway development in the entire Hong Kong SAR; 2. expand business from transport to land acquisition and property development 3. expand business from provision of railway services in Hong Kong to	We noted that the Real Estate Developers Association of Hong Kong supports the rail merger. We noted the view of Dr LI that the rail merger would bring positive effect to various parties in different aspects.

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			cross-border railway business. This should be welcomed as the new MTRCL will surely grow and become more effective. Integrated Rail-Property Development Study Team, The Hong Kong Polytechnic University ("The Study Team") considers that the current proposal to merge the Mass Transit Railway (MTR) and the Kowloon-Canton Railway (KCR) systems can bring many positive effects to urban planning and development of Hong Kong. Hong Kong lacks developable space and making railway the backbone of our mass transit system reduces the need for road construction and roadside pollution. This allows more land to be allocated for open space and pedestrian uses and achieves a sustainable urban spatial development pattern in the form of a compact city.	 We noted the view of The Study Team that the effect of the rail merger is positive and making railway the backbone of our mass transit system matches the objective of sustainable development.
2	• Dr LI Kui-wai, Associate	Financial Package	Dr LI Kui-wai, Associate Professor, City University of Hong Kong considered that:	Dr Li's views in this regard are in line with ours.

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	Professor, City University of Hong Kong • Dr HUNG Wing-tat, Associate Professor, The Hong Kong Polytechnic University • Mr David WEBB, Editor of Webb-site.com		(a) The 50 years franchise is appropriate. (b) The overall financial proposal is acceptable and reflects the financial responsibility and benefits of different parties (MTRCL, KCRC and the public). Dr HUNG Wing-tat, Associate Professor, the Hong Kong Polytechnic University considered that 50 years concession period appears a very long period for remediation if anything found wrong. According to experience in Europe, an OA of 10 to 15 years appears to be the norm.	The term of the service concession agreement at 50 years is intended to be co-terminus with the franchise of the post-merger corporation ("MergeCo"), and is considered normal given the substantial investment which would be required to be incurred by MergeCo for the maintenance, improvement and replacement of the concession assets during the concession period. If the duration of the service concession agreement was reduced substantially, MergeCo would not have sufficient time to obtain return on its investment or sufficient incentive to fully develop operational and service improvements and efficiencies. Further, it would take several years for MergeCo to fully achieve the estimated

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				synergy. In respect of some foreign operating agreements of 10-15 year tenure pointed out by Dr. Hung, we consider that such arrangements of operating agreements are not appropriate for the rail merger. Typically, such foreign operating agreements were for the operation of rolling stock in order to provide specified services to the travelling public and the related rail operators would not normally have the obligation to invest in rolling stock, track, signalling, stations and other infrastructure or the obligation to replace any of these, and would not therefore need to make substantial investment in the system as required by the railway operators in Hong Kong, except for the payment of access charges to the rail track owners. In case of serious default on the part of MergeCo, the service concession agreement may be

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				revoked.
			Mr David WEBB, Editor of Webb-site.com pointed out that he is planning to lead a campaign urging minority shareholder to vote down the merger because under the deal term MTRCL would have to pay KCRC an ever-increasing percentage of the revenue from KCR assets because thresholds in the formula for revenue-sharing will not be adjusted for inflation in the next 50 years. His analysis is as follows: (a) The inflation over time will push up the nominal revenue figure so that more and more revenue appears in the upper 35% band. In essence the deal removes upside revenue from a potential market-based reform of transport policy and ensures a reducing profit margin, at a speed which depends on the future rate of inflation. (b) For a 5% inflation from year 0 to year 50, the revenue, payment to KCRC, and KCRC	MTRCL advised that the deal is a balanced one bringing benefits to the travelling public, staff and investors.

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			revenue share changes from \$5.2bn to \$60bn, \$1bn to \$19.8bn and 19.8% to 32.9% respectively. The percentage share accelerates after year 8 when the revenue has broken through the \$7.5bn boundary and everything above charged at 35%. Mr David WEBB's also considered that the financial terms of the merger is not favorable to MTRCL because : (a) All the burden of the future maintenance and replacement of KCRC assets including trains, control and signaling equipment, tunnel repairs, and so on, will fall on MTRCL. All that MTRCL gets is the existing assets "as is", plus the finished KSL and LMC Spur Line, and at the end of the 50-year franchise, the rights to all of it will revert to KCRC. (b) In early years of the 50-year franchise, the burden of capital expenditure on KCR assets may be relatively light but the trains will	

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			either be worn out or obsolete within a couple of decades. At the time as revenue sharing will be increasing towards the maximum of 35%, capital expenditure will also be increasing, draining resources form MTRCL. In effect, long before 2056, when the franchise expires, virtually all of the assets apart from the tunnels themselves will have been replaced using MTRCL's dollar, but those replaced assets will then revert to KCRC as a "fully operational railway system" without any payment in return. (c) The 2005 EBITDA of KCRC is \$2, 356m or 43.8% of corresponding revenue. Even if assuming a gradual recovery to the long-term average of 49% EBITDA, when taking off a future share of about 30% for KCRC, leaving the margin of 19%, out of which MTRCL have to finance and depreciate future capital expenditure on asset replacement (this averaged 14% of KCRC revenues in the last 3	

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			years), leaving perhaps a low single-digit profit margin.	
3	• The Hong Kong Institute of Surveyors • Mr. Tony Chan Tung Ngok, Executive Director of Vigers Appraisal and Consulting Limited	Property package	The Hong Kong Institute of Surveyors strongly supports the property package of the merger proposal, as they believe the proposed property package is to the best interest of all involved parties and the terms are fair and reasonable. They also strongly support the valuation methodology and the valuation results adopted by the independent valuer. Their specific comments on the valuation methodology is as follows: (a) MTRCL will pay $4.91 billion for the right over the eight property development sites. This figure is based on the MergeCo's expected share of the assessed development profits for the sites. In order to arrive at the developer profit, the independent valuers have made use of the residual valuation based on how KCRC develops land and attains	We welcome the supporting views and clarifications of the Hong Kong Institute of Surveyors on the valuation concept and methodology. The professional views of the Hong Kong Institute of Surveyors in this regard are in line with ours.

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			profit. The valuation methodology is firstly to assess the value of the market sales proceeds and deduct the different costs, the net profit is then discounted over the development period to give a present value. As the sites will be developed in conjunction with developer partners, net profit will be apportioned according to their agreement. In essence, MTRCL is replacing KCRC in holding the development rights of the sites and MTRCL is paying KCRC what the latter should be able to realize in terms of its share of development profit as if there is no merger. (b) The market value of the sale proceeds is based on factual information and forecasts provided by KCRC and the costs to be deducted include the land premium, construction costs, project enabling work costs, tax and financing costs, professional fees, marketing costs, etc. (c) The independent valuers derived the market	

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			sales proceeds based on factors including location, site area, gross floor area, revenue, cost and project implementation programme of each of the eight sites and are therefore believed to be in line with the market.	
			The Executive Director of Vigers Appraisal and Consulting Limited Mr Tony Chan Tung Ngok also concurred with the methodology adopted by the surveyor appointed by Government. He also clarified that the consideration for the development right should be based on the present value of the expected net profit that could be realized by KCRC instead of the "expected proceed" and therefore the article in Ming Pao of 3 July 2006 which quoted his comment on the unit sale price might have given the wrong impression that the consideration for development right could be under-estimated.	Mr Tony Chan's views in this regard are in line with ours.

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4	• Dr LI Kui-wai, Associate Professor, City University of Hong Kong • Dr HUNG Wing-tat, Associate Professor, The Hong Kong Polytechnic University	Legal framework and the Rail Merger Bill	Dr LI Kui-wai, Associate Professor, City University of Hong Kong has the following comments on the Rail Merger Bill: (a) the Rail Merger Bill provides the legal framework, states and clarifies the responsibilities and functions of different parties including MTRCL, KCRC and the SAR Government that represents the public interests which includes the market power of the merged company, allocation of land resources, the projected future development and quality of the railway industry and service provisions. More important is that Government has to ensure that the instituted system that governs the operation of the merged company is effective, transparent and equitable. (b) The administrative responsibility of all parties should be spelt out in as much detail as possible. The successful application of the 50 years franchise relies on good governance	The Rail Merger Bill provides the necessary legal framework for regulating MergeCo. The Administration will work closely with the Bills Committee in the latter's scrutiny of the details of the Rail Merger Bill.

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			of the administrative machinery and the administrators. Dr HUNG Wing-tat, Associate Professor, The Hong Kong Polytechnic University has the following comments: (a) Government in its announcements and papers to the public has never stated explicitly the purposes/objectives of the merger. (b) Over the past 30 years, it appears that the "prudent commercial principle" and the "railway cum property" development model work well. (c) The merging of KCRC into MTRCL completes the restructuring of the railway operation to work entirely under the "prudent commercial principle".	 As the Administration stated in the paper entitled "Merger of MTR and Kowloon-Canton Railway Systems – Proposed Way Forward" for the joint meeting of LegCo Penal on Transport and Financial Affairs held on 12 April 2006, implementing the rail merger would bring overall benefits to the community as a whole. Through the merging of the two railway systems, the two railway corporations can supplement each other through their respective strength to bring us a world-class rail operator, which would enhance the competitiveness of Hong Kong both in the Mainland market and in the international arena. Besides, the travelling public would get immediate benefit out of the rail merger through fare reduction from the first day of the merger and better interchange arrangements. An objective and transparent fare adjustment

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				mechanism would also be introduced to replace the existing fare autonomy of the two railway corporations.
5	• Dr LI Kui-wai, Associate Professor, City University of Hong Kong • Integrated Rail-Property Development Study Team, The Hong Kong Polytechnic University ("The Study Team")	Market competition	Both Dr LI Kui-wai, Associate Professor, City University of Hong Kong and the Integrated Rail-Property Development Study Team, The Hong Kong Polytechnic University ("The Study Team") consider that the rail merger will not create monopolistic problem. Dr LI Kui-wai considered that the two railway companies in Hong Kong do separately hold a certain degree of market monopoly already. In reality it will be difficult for the merged company to exercise additional monopolistic market power in the railway transport business. The rail merger will bring more social benefits including the reduction in fares and abolition of second boarding charge. The social benefit should be seen from a long term perspective and be	The view of Dr LI and The Study Team that the rail merger will not create monopolistic problem is in line with ours. The MergeCo after the rail merger will continue to face intense competition from other modes of public transport, in particular public buses. Market competition will require MergeCo to provide quality service at competitive fare level in order to maintain its attractiveness to commuters. MergeCo would be required by law to provide proper and efficient service. Its railway operation will also be subject to the regulation under the operating agreement to be entered into between MergeCo and the Government. Upon the rail merger, an objective and transparent fare adjustment mechanism will be introduced to regulate adjustment of MergeCo's fares, replacing the

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			considered an improvement in the overall transport infrastructure in Hong Kong. "The Study Team" consider that the worry of merger may lead to undesirable monopoly is unjustified and has the following comments: The key competitors of the existing two rail systems, which currently serve separate geographical catchment areas, are the public franchised buses. Provided that the public buses maintain their service quality and competitive fares and allowing the riders to choose, the rail merger cannot sustain a monopolistic position. The proposed rail merger can better achieve an economy of scale by running an expanded railway network. This has the benefits of enhancing operational efficiency, reducing overall costs and maintaining fare stability in the long run.	existing fare autonomy of the two railway corporations.

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6	• Staff Consultative Council, MTR Corporation Limited ("SCC MTRCL") • The Coalition of 5 Unions of MTRCL and KCRC ("The Coalition") • KCRC Staff Consultative Committees ("KCRC CC") • Hong Kong Mass Transit Railway Staff General Association ("SGA")	Staff	SCC MTRCL, the Coalition, KCRC CC and SGA raise the following points: (a) SCC MTRCL considers that all SCC Councillors and Joint Consultative Committee ("JCC") Staff Representatives are elected directly by staff and they take up an active role in communication, monitoring, etc. This is directly related to the Corporation's continuous improvement. If a comprehensive communication mechanism is incorporated into the Mass Transit Railway Ordinance ("MTRO"), it will be beneficial to maintaining proper and efficient services in the future. (b) SCC MTRCL considers that the current provision on the liabilities for committing an offence of negligent act or omission by	As pointed out by SCC MTRCL, MTRCL has a well-established mechanism for consultation and communication with representatives of SCC, CC and unions. The situation of KCRC is the same. The established mechanism has proved to be effective in resolving matters of common concern to both the management and staff side in the past. Due to concerted efforts of the management and the staff side, the two corporations have maintained good and harmonious staff relations through these communication channels. The current arrangement has been working well. We do not consider it necessary to legislate the internal communication mechanisms of the corporations. We share the same view of SCC MTRCL.

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	• Kowloon-Canton Railway Employees Association ("KCR EA")		employee; and an offence of willfully endangering safety as stipulated in sections 29 and 30, Part III of the MTRO are appropriate.	
			(c) Section 41, Part IX of the MTRO covers employment-related matters. SCC MTRCL and SGA hope that similar provisions would continue to be adopted in the MergeCo in future, so that the employment rights of staff will continue to be legally protected.	The Rail Merger Bill has addressed the concern of SCC MTRCL and SGA.
			(d) The Coalition and the KCR EA request that MergeCo should protect staff interests including job, years of service, professional qualification, salary, fringe benefits and retirement scheme, etc. The Coalition considers that the protection should be provided through legislation.	Under the merger package, all serving staff of the two corporations will continue to be employed by MergeCo on their prevailing terms and conditions upon implementation of the rail merger. The Rail Merger Bill contains specific provisions to stipulate that the prevailing retirement schemes of the staff of the two corporations would continue to be effective and would be deemed for all

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				purposes to be a single continuing employment.
			(e) SCC MTRCL considers that staff generally accept the reliability targets, which cover train service, automatic fare collection systems, escalators and lifts, as stipulated in the Mass Transit Railway Corporation Limited Operating Agreement of 2000. In a stable working environment, staff will have more confidence to perform their duties. In addition, the Corporation has been proactively upgrading the service level laid down in the OA on an annual basis in order to provide a proper and efficient service to the public in Hong Kong. However, MTRCL and KCRC differ in terms of working culture, environment, equipment, nature and standards, and hence time would be needed for integration. SCC MTRCL understands that there are high expectations from society on the rail	The Performance Requirements (PRs) and Customer Service Pledges (CSPs) of the two corporations are set at very high levels. The range of measures is also very wide. If the merger is implemented, the PRs and CSPs of the MergeCo in respect of individual lines will be at least as high as the existing levels of requirements and targets for those lines. To facilitate integration of cultures of the two corporations, the two corporations have conducted a series of cultural integration workshops to increase mutual understanding among their staff. The two corporations will continue their work in this respect.

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			services in Hong Kong, but invisible pressure should not be asserted on staff. SCC MTRCL hopes society would understand their difficulties and be accommodating in the early stage of the merger. SCC MTRCL will, however, pledge to do their best to meet or exceed the reliability targets in railway operation.	
			(f) SCC MTRCL considers that the rail merger will bring about synergy and there will inevitably be overlapping of positions after the merger. The Corporation will also continue to streamline its structure to better manage the operating cost, thus threatening staff's job security. SCC MTRCL urges the Corporation to exert every effort to look after all staff members. Same as previous practices, the Corporation should resolve the manpower situation through natural staff turnover and redeployment. Staff	The two corporations have made public commitment to look after the interests of all staff, including both frontline and non-frontline staff. Both frontline and non-frontline functions will continue to exist in MergeCo. Not being classified as frontline staff does not necessarily mean that there will be job security issues to the staff concerned. The majority of staff are expected to remain in their prevailing jobs. The two corporations estimated that due to expansion of railway network, business growth, turnover and retirement of staff, a total of 1,300 job

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			redundancy should not be implemented lightly as it would affect the concerned staff's livelihood and lower the morale of the serving staff. KCRC CC anticipates that there will be surplus staff in functions and departments. Therefore, a clear staff re-deployment policy is essential to reduce anxiety among staff. The re-deployment policy should be understood by all staff and be announced as soon as practicable.	vacancies would be available in the first 3 years after the merger, which is more than adequate to absorb the estimated 650-700 staff synergies. Although there will be skills mismatch, the MergeCo would consider staff's request for job position and make every effort to re-deploy affected staff to available vacancies and provide training and assistance to help staff settling in their new jobs. Both corporations have a good track record in having re-deployed over 1,000 staff to take up positions in other functions in the past. Future staff arrangements will be made through a fair and equitable process, with inputs from both MTRCL and KCRC. The two corporations will consult their staff on the staff arrangements before making a final decision.
			(g) SCC MTRCL worries that in aligning the terms, it will lead to a deterioration of staff's salary and benefits, e.g. retirement scheme, medical benefit, annual leave, etc. SCC	The existing terms and conditions of the two corporations are broadly comparable but are not entirely the same. To facilitate the integration of the human resources, the two corporations have

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			MTRCL opines that currently the employment terms and conditions of the two companies are different. In aligning the employment terms and conditions for the merged company, the Corporation will take cost effectiveness, competitiveness and market practices into consideration. Should there by any differences between the new terms and the existing ones, SCC MTRCL hope that the Corporation would continue its usual practice of consulting staff to work for consensus before making final decision. SGA and KCR EA demand that the terms and conditions of the MergeCo should be announced before the merger. The Coalition and SGA opine that staff's wish should be taken into account when implementing the new terms and conditions of employment, and the Coalition and KCRC EA urge the management not to force staff to accept the new terms and conditions	indicated that there will be a single set of employment terms and conditions and grading structure for staff of MergeCo. The two corporations have jointly appointed an independent consultant to study in details the grading and pay structure and terms and conditions of MergeCo. It is expected that the study would be completed by the end of 2006. The two corporations would consult staff on matters affecting them and give due regard to the views of staff. The corporations would consult their staff on the new terms and conditions before making a final decision. Therefore, staff will be duly consulted. MTRCL and KCRC expect that the set of new terms and conditions as a total package would not differ significantly from the existing ones and would be competitive in the market.

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			of employment. The Coalition advocates that staff should be employed on prevailing terms and conditions before reaching consensus and SGA opines that the new terms and conditions should only be implemented upon receiving written consent from staff. KCRC CC opines that there are differences between the new package and the existing terms and conditions of individual KCRC and the MTR staff. A mechanism and appropriate conversion arrangements should be in place so that staff can know if he / she would be worse / better off where such a gap exists.	
			(h) Under the rail merger, the Corporation is committed to protect the job security of frontline staff only. SCC MTRCL and SGA found this arrangement unreasonable. All along, non-frontline staffs have given great support and assistance to frontline	After the rail merger, both frontline and non-frontline positions will continue to exist in MergeCo. The two corporations have made public commitment to look after the interests of all staff, including both frontline and non-frontline staff. Not being classified as

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			staff. Their contribution is apparent. During the merger process, colleagues will continue to work hard. However, non-frontline staff may not enjoy the job security that they deserve at the end. Therefore, SCC MTRCL urges the Corporation to dedicate every effort to look after all staff members while SGA asks for provision of job security and proper arrangements for all the staff at fundamental level in the non-frontline positions, including appropriate training and reasonable deployment so as to protect their interest of employment. The Coalition and KCR EA also suggest that sound arrangements should be provided for the non-frontline staff.	frontline staff does not necessarily mean that there will be job security issues to the staff concerned. The majority of staff are expected to remain in their prevailing jobs. The two corporations estimated that due to expansion of railway network, business growth, turnover and retirement of staff, a total of 1,300 job vacancies would be available in the first 3 years after the merger, which is more than adequate to absorb the estimated 650-700 staff synergies. MergeCo would make every effort to re-deploy affected staff to available vacancies and provide training and assistance to help staff settling in their new jobs. Both corporations have a good track record in having re-deployed over 1,000 staff to take up positions in other functions in the past. In overall terms, there would be more career development opportunities for staff after the rail merger. The two rail corporations have organised workshops and briefings to keep staff posted of the concerned information.

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			(i) The Coalition, SGA and KCR EA opine that frontline staff should be transferred to MergeCo directly. They need not go through any selection or appointment process. The KCRC CC considers that (i) direct appointment should be adopted for all cases where the number of job matches with the number of eligible staff. Selection process is only invoked for exceptional cases. (ii) Selection of staff should be based on capability, qualification and relevant experience of the staff, and should be de-linked from their current position level and current pay level. (iii) Permanent and contract staff should be treated equally. (iv) Should there be a selection panel, members of the panel should comprise department heads or line managers of the respective functions from both corporations. (v) The current ratio of staff of the two	Under the merger package, all serving staff of the two corporations would be employed by MergeCo upon the implementation of the rail merger. The two corporations have indicated that majority of the frontline staff would stay in their current jobs after the rail merger. As there may be slight modification to the manpower arrangement at the interchanging stations in order to provide for seamless interchange at these stations for the benefit of passengers, posting arrangements will be made for a small number of frontline staff as appropriate. MergeCo will re-deploy the affected staff to other jobs of similar nature. Only the senior management would be selected before the merger implementation date. As for all other staff, the selection, if necessary, would be handled after the merger. Future staff arrangements of MergeCo would be conducted through a fair and equitable process. The selection criteria will be drawn up

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			corporations should be a reference for the future mix of staff of the merged company. KCR EA urges that contract staff on permanent posts should be changed to permanent terms. The Coalition, SGA, KCRC CC and KCR EA	jointly by the two corporations. The criteria will include requirements of the jobs, performance, experience and capability of the individual staff concerned. Selection panels comprising representatives from both MTRCL and KCRC will be appointed to conduct objective assessments. Hence, it is not appropriate to determine the manpower arrangement of MergeCo in accordance with the current ratio of staff in the two corporations. The two corporations will set out the principles, systems and procedures for the selection and would consult their staff before finalizing the details. As for arrangements for contract staff, the corporations have committed to looking after the interests of all staff. Depending on the nature of the job positions of the contract staff, MergeCo would explore development opportunities for them in order to retain talents.

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			also raise the following additional points: (a) The Coalition and KCR EA opine that staff unions should be allowed to participate directly in issues in relation to staff interests, manpower structure, pays and benefits as well as personnel policies. SGA demands the management to increase the degree of participation of unions in the arrangements for staff interests so that staff issues arising from the merger could be effectively, promptly and reasonably resolved. (b) KCRC CC points out that special considerations should be given for staff close to their retirement and to the future MergeCo's retirement schemes. (c) The Coalition and KCR EA opine that the appeal mechanism should be open, fair and independent. KCR EA further suggests	The two corporations would, throughout the merger integration process, continue to maintain regular communications with staff, SCC, CC, staff unions and the Coalition and consult them on merger-related matters affecting them before making any final decisions. The Administration has relayed KCRC CC's comment to the corporations for consideration. The two corporations confirmed that staff arrangements of MergeCo would be handled in a fair and equitable manner. The appeal

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			participation of government in the appeal mechanism.	mechanism, which has recently been finalized after thorough consultation with SCC/CC and unions, has duly followed this principle. Staff arrangements are matters that should best be resolved through discussions between staff side and the management. Same as the current practice, it is not appropriate for the Government to be involved directly in the handling of staff appeal matters in future.
			(d) The coalition considers that the "communication mechanism involving staff, management and government" should be continued, strengthened and developed, and transferred to the new merged company to continue its proactive function. SGA urges that during the merger integration process the management and MergeCo should proactively communicate with unions.	The two corporations have maintained regular communication with their staff, SCC/CC and staff unions on merger-related issues. These efforts will continue after the merger. The Administration has met with representatives of the staff unions in the past to listen to their views on the merger. Future communication arrangements can be made having regard to development of the subject.
			(e) The Coalition should receive the same	The two corporations indicated that, similar to

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			treatment and respect like other consultation bodies in the companies. The companies should set up liaison office for the Coalition. As for the launching of the Voluntary Separation Scheme (VSS), KCRC CC raises the following points: (a) The VSS and its terms should be announced as early as possible. (b) All staff should be eligible to opt for the voluntary separation scheme. (c) Benchmark what is offered under the voluntary separation scheme with the market.	other staff consultative bodies, the Coalition is one of the communication channels between staff side and the management. The two corporations indicated that the VSS would be launched for affected staff in due course. They would consult staff on details of the VSS.
7	• Sir Wilfrid NETWON CA(SA) CBE, the former Chairman & Chief Executive	Fare adjustment mechanism (FAM) / fare reduction	Sir Wilfrid NEWTON, Dr LI Kui-wai and Professor RIDLEY support the FAM proposal. Sir Wilfrid NEWTON considers that: (a) Urban mass transit railways do not exist in isolation from competing modes of public	We noted Sir Wilfred's affirmative view on the FAM.

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	of the Mass Transit Railway Corporation • Dr LI Kui-wai, Associate Professor, City University of Hong Kong • Professor Tony M. RIDLEY, President of the Railway Technology Strategy Centre (RTSC), Imperial College London • Dr HUNG Wing-tat, Associate Professor, The		transport, or from the wider financial and general business community. Railway fares must be set at levels that are: 1. sufficient to cover operating costs, recognising improvements in productivity won by sound management; 2. adequate to remunerate the company's historical and prospective cost of capital; 3. designed to attract passengers in numbers calculated to cover (1) and (2) above; 4. low enough to compete effectively with other modes of transport; 5. capable of rewarding shareholders fairly; and 6. finally, able to satisfy political masters. The FAM agreed between MTRCL and Government appears upon inspection to satisfy the six criteria mentioned above.	

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	Hong Kong Polytechnic University • Mr David WEBB, Editor of Webb-site.com		(b) The FAM is a prerequisite of the proposed Merger that, taken as a whole, is expected to be beneficial to stakeholders of both companies, including shareholders. (c) The FAM must be applied on the so-called ‘Direct Drive’ (i.e. automatic application) basis. This formulaic approach to fare adjustment seems to carry risks for the merged companies to a degree that should satisfy the demands of the most determined Members of LegCo and of officials. Any further direct political and /or official involvement would carry dangers for management and indeed for politicians and/or officials too. Dr. LI Kui-wai considers that the FAM that composes of changes in composite Consumer Price Index, the wage index and the productivity	We noted Sir Wilfred’s affirmative view that FAM is part and parcel of the merger package and will bring benefit to all stakeholders. We also noted Sir Wilfred’s view that FAM must work on a ‘direct-drive’ basis. We noted that Dr. LI has positive views on the FAM.

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			factor is similar elsewhere. In reality, one would expect little change in the fare, especially there is also a trigger mechanism of 1.5%. The advantage is that this provides overall price stability and transparency, though the FAM would be subject to a review every five years. Professor RIDLEY opines: (a) The FAM is commonly adopted worldwide by many regulators of utilities (electricity, gas, water, as well as railways) as it allows the operator stability with which incomes are relatively predictable. This is particularly important for asset managers (such as the MTR) where investment, renewals and maintenance require a relatively assured level of income (from fares) to sustain the quality of service offered in the long term. (b) The FAM agreed for the merged company, takes into account both prices (CPI) and	 We share the same view of Professor Ridley.

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			wages. It is objective and transparent, and understandable to the public. (c) The formula, by allowing an automatic annual adjustment, protects the interests of the workforce of the metro by providing income that can support fair wages, protects the legitimate interests of shareholders who receive a fair return on the capital they provide, protects the interests of taxpayers by giving strong management incentives to deliver efficiency, and protects the interests of the travelling public against unjustified fares increases. (d) Whilst a FAM protects the operator against the management difficulties due to frequent and unpredictable interventions, it does not remove the ability and the duty of the regulatory body to review policies in the light of changing circumstances. (e) In order to facilitate stable business decisions by the metro to deliver sustained,	

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			long-term service quality, it is essential that the agreed formula for annual adjustments in fares is adopted automatically and in full.	
			Dr LI opined that the abolition of the second boarding charge is a definite plus. However, whether the other price concessions are appropriate can be examined from the projected profit levels of MTRCL in the merger. The overall price concessions are mild and favour the long journey travellers more.	The fare reduction package is a fair and balanced proposal. Railway fares would be reduced from day one of the merger. It is estimated that it would benefit 2.8 million daily rail passenger trips. This is a substantive fare reduction proposal. Some passengers can save about \$100-\$200 a month. The fares for long-distance journeys would be reduced by a minimum of 10% and there would be different reduction rates for medium and short distance journeys. A total of 340,000 daily passenger trips will enjoy a fare reduction of at least 10% per trip. Another 1.16 million daily passenger trips will enjoy a minimum of 5% reduction per trip. The fare reduction package can reduce the burden of travelling expense of the public who live in remote areas. It also caters for the needs of the

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				medium and long-distance travellers who work in districts outside their places of residence. The fare reduction package supplements other measures implemented by the Administration to encourage employment.
			Dr HUNG opined that cost of transport has a very heavy bearing on the affordability and thus accessibility of the passengers. Railway carries over 30% of public transport passengers in Hong Kong. The fare level of railway also has a leverage effect on other competing public transport modes. Therefore, Government's control over the railway passenger services is of vital importance to ensure affordability through the careful exercise of fare leverage. However, the tax paying public also has a high expectation that Government should not subsidise public transport services.	Railway services are subject to close monitoring by the Administration. Fare adjustment of MergeCo in future will be regulated by the FAM.
			Dr HUNG also pointed out that while the	The reduced fares effective from the

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			measures of FAM and fare reduction certainly address the affordability issue, it is crucial that the fare reduction can bring the fare down to a level that most people can afford and the FAM simply maintain this level in real terms in the years to come.	implementation of the merger will be the base fares for the annual fare assessment and adjustment under the FAM.
			Dr HUNG opines that a proposed five-year review period of FAM is considered adequate.	We noted Dr. HUNG's affirmative view on our proposal.
			In addition, Dr HUNG considers that to provide an affordable high-quality railway service is to the best benefits of both the MergeCo and the public. Dr HUNG suggests the MergeCo should seriously consider incorporating "to provide an affordable high-quality railway service" as one of the missions of the corporation.	The Administration has relayed Dr. HUNG's suggestion to MTRCL for consideration.
			Mr David WEBB considers that the independent shareholders are likely to vote against the merger package because MTRCL would have to give up	The FAM is part and parcel of the merger package. We believe the merger package is fair and reasonable and it has balanced the interests of

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			fare autonomy on most of its merged network and be bound by an "inflation minus X" formula, without receiving any payment for surrendering that autonomy. A huge selling point in MTRCL's prospectus from 2000 was "[MTRCL] has autonomy to determine its own fares without any requirement to obtain the approval of Government or any other body". Mr David WEBB also opines that the FAM formula allows for no real (inflation-adjusted) increase in fares.	all stakeholders.
8	• Sir Wilfrid NETWON CA(SA) CBE, the former Chairman & Chief Executive of the Mass Transit Railway Corporation • The Real Estate	Property development right	Sir Wilfrid NEWTON support the carrying out of property development by MergeCo and considers that: (a) Construction of railways creates opportunities for property development on sites in the immediate vicinity of and above stations. MTRCL has paid Government the open market value of the sites and called for competitive tenders from potential property developers. The net proceeds from the	We noted that Sir Wilfred Newton supports the carrying out of property development by MergeCo after the rail merger. The inclusion of KCRC's property management business as an integral part of the merger transaction is essential in order to ensure that the connection and integration benefits between railway and property can continue in future. If rail and property were managed separately, there would be less incentive for the respective parties to align their interests

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	Developers Association of Hong Kong • Dr HUNG Wing-tat, Associate Professor, The Hong Kong Polytechnic University • Mr David WEBB, Editor of Webb-site.com • Integrated Rail-Property Development Study Team, The Hong Kong Polytechnic University ("The		process gave government a fair market price for the sites and the net proceeds retained by MTRCL made a significant contribution towards the cost of railway construction. The Merged Company could well repeat similar results from properties in the future. (b) A number of properties were retained by MTRCL for long-term investment. Sound commercial management of the retained properties has provided growing repetitive income that has contributed to MTRCL's ability to maintain fares at competitive levels while satisfactory rewarding the capital cost of the retained properties. The Real Estate Developers Association of Hong Kong is against using land as subsidy for construction of railway projects and considers that: (a) subsidy should not be by land but by cash injection approved by the Finance Committee	and to ensure the optimal integration of the two, which could result in loss of connection and integration benefits. Another important reason for properties above or adjacent to stations to be managed by the rail operator is to ensure a safe and efficient operating environment for rail operator. In summary, MTRCL, in taking on the property package, will be best placed to ensure optimal management of both railway and property to the benefit of both sets of users. The property package is to be sold to MTRCL on market terms, and hence there is no question of using land or property to subsidise railway. The property package is an integral part of the merger proposal.

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	Study Team") • Professor Tony M. RIDLEY, President of the Railway Technology Strategy Centre (RTSC), Imperial College London		of the Legislative Council. (b) Land subsidy will interfere with Government's land supply mechanism and weaken its ability to manage the supply. The proper way to dispose land associated with railway projects is to go through the channel of the centralized Land Application List Mechanism. Dr HUNG Wing-tat, Associate Professor, The Hong Kong Polytechnic University considered that over the past 30 years, it appears that the "prudent commercial principle" and the "railway and property" development model work well. Government subsidy of property development has many merits and allows the railway operator to plan the stations and properties above an adjacent to the stations to best facilitate and attract the riders, i.e. the integration of the stations and nearby development can best be achieved.	We noted Dr Hung Wing-tat's positive views towards the "Rail and property development model".

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			Mr David WEBB, Editor of Webb-site.com considered that the introduction of the mechanism by which Government can control the level of flat production by controlling the rate at which MTRCL tenders new property developments would remove value from MTRCL shareholders. This amount to further intervention in the commercial decisions of MTRCL, which would be surrendering autonomy to make its own decisions in the best interests of all its shareholders, and no payment is offered for that surrender. Whether to slow down or accelerate its development should be a decision for MTRCL on its own, not driven by Government. In addition, Mr. David Webb is of the view that currently Hong Kong Government pursues a socialist transport policy in which all forms of domestic public transport are indirectly subsidized. Rail fares have to be maintained	On Mr. David Webb's comments, MTRCL responded that: • The level of flat production by MTRCL has always been controlled by MTRCL based on prudent commercial principles while taking into consideration Government's input. • Furthermore, MTRCL has always worked with Government on an informal basis to ensure that MTRCL's level of flat production is in the interests of both the Government (i.e. the overall Hong Kong property market) and MTRCL (i.e. enhances shareholder value). • Therefore the arrangement to introduce the mechanism is merely to formalize the existing practice. "Rail and property development model" is a successful model and worked well in Hong Kong. Granting property development right to railway corporations is one of the ways to bridge the funding gap of railway projects that are not

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			low to compete with the subsidized bus. In facing all these subsidized competitors, the only way Hong Kong's railways can be made financially viable is to subsidise them too, mainly with property development rights.	financially viable.
			The Study Team considers that the MTR integrated rail-property development model has demonstrated many good examples in satisfactorily resolving potential conflicts. The proposed rail merger enables this model to be implemented in a much wider context. The Hong Kong integrated rail-property development model is a rather unique model which has achieved high regard internationally. The Study Team considers that both MTRCL and KCRC rely on property development to support their operation. Under an integrated rail-property development model, the rail operator can capture the values to finance railway construction, improve ridership of the railway and its	We noted that The Study Team holds positive views towards the "Rail and property development model".

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			operational viability, enhance convenience and efficiency, and generate enormous benefits to the society and economy. Professor Tony M. RIDLEY considers that the Hong Kong rail-property model works well in the public interest.	 We noted that Professor Tony Ridley holds positive views towards the "Rail and property development model".'
9	• Dr HUNG Wing-tat, Associate Professor, The Hong Kong Polytechnic University • Integrated Rail-Property Development Study Team, The Hong Kong	New railway projects	Dr HUNG commented that the construction of all the current railway lines are funded by Government, either by direct injection of funds, serving as loan guarantor, or granting property development rights to the operators. Government must clarify the funding arrangement of new railway projects in future. Dr HUNG also commented on the planning of railway development as follows: (a) Currently, planning of further railway development is conducted regularly by	According to the merger package, for future new railway projects that are natural extensions of MTRCL's railways, the status quo will be maintained. For new railway projects that are not natural extensions of MTRCL's railways, the Government may decide to implement the projects by adopting the "Ownership Approach" (i.e. MergeCo would finance, operate and maintain the railway) or the "Service Concession Approach" (i.e. Government would fund the construction and MergeCo would be granted a service concession to operate the new railway).

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	Polytechnic University ("The Study Team")		Government, independent of the railway operators. The major consideration is economic returns to the entire community rather than financial return to individual railway operator. (b) With the existence of more than one railway operators, Government has the freedom to choose an operator which can offer a better deal. (c) In future with only one operator MergeCo which has a prime objective of profit seeking, Government may not have the liberty of a choice. The influence of the operator will not be limited to the station but the implementation of the entire railway development programme. The consideration of the financial returns for the operator will dominate railway development programmes. This may not be to the best benefit of the community. (d) Government should seek ways to ensure the	Therefore Government would have more flexibility and choice in the approach for implementing new railway projects after the merger.

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			timely implementation of the railway development programme. It should not be hindered by unpredictable consequences of negotiation with the MergeCo. Construction and ownership of new railway lines by KCRC should remain as a possible option before Government identifies effective ways to implement railway programme. The Study Team considers that the merged company can formulate a more comprehensive planning and development option for the Shatin to Central Link. The Tsing Yi Station is a good example of comprehensive planning and development by a single rail operator.	