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Panel on Transport and
Panel on Financial Affairs

Minutes of joint meeting held on
Wednesday, 12 April 2006, at 10:45 am
in the Chamber of the Legislative Council Building

Members present : Members of the Panel on Transport

Hon LAU Kong-wah, JP (Chairman)
* Ir Dr Hon Raymond HO Chung-tai, S.B.St.J., JP
Hon Miriam LAU Kin-yee, GBS, JP
* Hon Abraham SHEK Lai-him, JP
Hon LI Fung-ying, BBS, JP
Hon Albert CHAN Wai-yip
Hon LEE Wing-tat
* Hon Jeffrey LAM Kin-fung, SBS, JP
Hon LEUNG Kwok-hung

Members of the Panel on Financial Affairs

Hon Bernard CHAN, JP (Chairman)
Hon Ronny TONG Ka-wah, SC (Deputy Chairman)
Hon James TIEN Pei-chun, GBS, JP
Hon LEE Cheuk-yan
Hon CHAN Kam-lam, SBS, JP

(*also a member of the Panel on Financial Affairs)

Members attending : Hon Albert HO Chun-yan
Dr Hon YEUNG Sum
Hon Audrey EU Yuet-mee, SC, JP

Members absent	**:**	Members of the Panel on Transport Hon Andrew CHENG Kar-foo (Deputy Chairman) Hon Mrs Selina CHOW LIANG Shuk-yee, GBS, JP Hon LAU Chin-shek, JP Hon TAM Yiu-chung, GBS, JP Hon Tommy CHEUNG Yu-yan, JP Hon WONG Kwok-hing, MH Hon CHEUNG hok-ming, SBS, JP * Hon Albert Jinghan CHENG Members of the Panel on Financial Affairs Dr Hon David LI Kwok-po, GBS, JP Hon James TO Kun-sun Hon SIN Chung-kai, JP Hon Emily LAU Wai-hing, JP Hon Andrew LEUNG Kwan-yuen, SBS, JP Hon WONG Ting-kwong, BBS Hon CHIM Pui-chung Hon TAM Heung-man (*also a member of the Panel on Financial Affairs)
Public Officers attending	**:**	Dr Sarah LIAO Secretary for the Environment, Transport and Works Mr Frederick MA Secretary for Financial Services and the Treasury Mr Joshua LAW Permanent Secretary for the Environment, Transport and Works Mr Patrick HO Deputy Secretary for the Environment, Transport and Works Mr Martin GLASS Deputy Secretary for Financial Services and the Treasury

Attendance by invitation	:	Citigroup Mr Frank SLEVIN Managing Director and Chief Operating Officer, Asia Pacific Investment Banking HSBC Mr Michael KERSHAW Global Head of International Business Development for China
Clerk in attendance	:	Mr Andy LAU Chief Council Secretary (1)2
Staff in attendance	:	Ms Connie FUNG Assistant Legal Adviser 3 Ms Sarah YUEN Senior Council Secretary (1)6 Miss Winnie CHENG Legislative Assistant (1)5

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I Election of Chairman

Mr LAU Kong-wah was elected Chairman of the joint meeting.

II Merger of MTR and Kowloon-Canton Railway Systems —— Proposed way forward

(LC Paper No. CB(1)1291/05-06(01) - Information paper provided by the Administration)

2. The Chairman said that this joint meeting was convened to enable the Administration to brief members on the proposed way forward for the merger of MTR and Kowloon-Canton Railway (KCR) Systems.

3. Mr Abraham SHEK declared interest as a member of the Managing Board of the Kowloon-Canton Railway Corporation (KCRC).

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4. Members noted the letter from Mr WONG Kwok-hing dated 11 April 2006 on the rail merger proposal which was tabled at the meeting.

(*Post-meeting note*: The letter was circulated to members vide LC Paper No. CB(1)1301/05-06(01) after the meeting.)

5. The Secretary for the Environment, Transport and Works (SETW) thanked the Panels for arranging the joint meeting at such short notice. She said that the Government had entered into a non-binding Memorandum of Understanding (MoU) with the MTR Corporation Limited (MTRCL) on the structure and the terms for the proposed merger of the MTR and KCR systems on the day before the meeting, i.e. 11 April 2006. The package proposal was a fair and balanced deal. It would bring overall benefits to the community as a whole. It also balanced the interests of all stakeholders. With the aid of PowerPoint presentation, SETW then briefed members on the proposed fare reduction package, the future fare adjustment mechanism, the agreement of MTRCL and the Kowloon-Canton Railway Corporation (KCRC) to provide fully integrated interchange stations for the Shatin to Central Link (SCL), the planned improvements to the existing interchange stations, the staff-related matters arising from the rail merger and the regulatory regime for the post-merger corporation (MergeCo), etc.

6. The Secretary for Financial Services and the Treasury (SFST) then briefed members on the proposed transaction structure, financial terms and property package of the rail merger proposal. He said that if there was general support for the rail merger, the Administration would proceed with the necessary legislative exercise and submit a bill to the Legislative Council. MTRCL's minority shareholders would be invited to approve the merger proposal if and after the necessary legislative amendments had been approved by the Legislative Council. The Government, being both the sole shareholder of KCRC and the majority shareholder of MTRCL, would not take part in the voting on the proposal.

(*Post-meeting note*: The presentation materials were tabled at the meeting and circulated to members after the meeting vide LC Paper No. CB(1)1301/05-06(02)).

Proposed merger

7. Mr Albert CHAN remarked that originally, the rail merger proposal could bring in substantial benefits to the general public. However, he had great reservation on the transaction structure and terms for merging the MTR and KCR systems as presently proposed. He said that the adoption of a more objective and transparent fare adjustment mechanism was already an established Government policy. It would be adopted irrespective of the result of the rail merger. On fare reduction, as MTRCL earned a huge profit of $8.4 billion in 2005, the Corporation should have been offering fare reduction to its passengers. Against this background, he considered that the Administration had misled the public that if they wished to enjoy the fare reduction, they would have to

accept the merger proposal. He also commented that due to improper planning, KCRC had been suffering from heavy financial loss. However, with the implementation of the on-going railway programme, the future financial performance of KCRC should be significantly improved. He therefore commented that it would be to the disadvantage of the Government, and hence the people of Hong Kong who owned the assets of KCRC, to conclude a merger deal at this juncture and in the proposed terms as suggested by the Administration.

8. SFST said that the package proposal was a fair and balanced deal and would bring overall benefits to the community as a whole. It also balanced the interests of all stakeholders. He disagreed that the deal was concluded to the advantage of MTRCL. In agreeing the financial terms with MTRCL, the Government had sought to structure the financial terms in order to capture the likely future performance of the KCR System. A revenue-sharing mechanism was also proposed so as to ensure that KCRC would enjoy the upside benefits when the revenue from the KCR system increased. Further, MergeCo would be responsible for the maintenance and improvement of the KCR system, including the replacement of the concession assets, during the concession period.

9. Judging from the prevailing practices of MTRCL, Mr Albert CHAN remained unconvinced that an effective monitoring mechanism was in place for regulating the operations of MTRCL, a listed company. Mr CHAN and Mr LEUNG Kwok-hung pointed out that as some family households had to spend around 20% of their income on transport, they were worried that the proposed rail merger would not benefit the general public as MergeCo would merely focus on profit maximization. Employees' benefits and public interests might be jeopardized as a result.

10. In response, SETW did not agree that there was no effective monitoring mechanism for MTRCL. To address public concern that the process for adjustment of transport fares should be more objective and transparent and should allow for reduction as well as increase in fares, the Administration already proposed a new fare adjustment mechanism under the rail merger proposal. SETW also highlighted the positive feedbacks of international media that Hong Kong had a world-class railway system with reasonable fares. She remarked that Hong Kong people should not belittle the achievements of MTRCL and KCRC in this respect.

11. SETW further said that in considering an appropriate arrangement for railway fare adjustment and fare reductions, the Administration had given due regard to passengers who needed the benefits most. She said that short-route fares in Hong Kong were among the lowest in comparison with some other cities whilst it was not the case for the fares of long-distance routes. The Administration considered that there was more scope for railway fare reduction for long-distance trips than for short-distance trips in Hong Kong. Regarding service regulation, the Administration would continue to monitor vigorously the performance and safety of the railway systems, whilst market force would help ensure that railway operation would address passenger demand.

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12. Mr Albert CHAN and Mr LEUNG Kwok-hung expressed concern that news about the rail merger talk had been leaked intentionally to the market which had led to unusual price movement in MTRCL shares. As such, the Administration should look into the matter. In response, SFST said that the Securities and Futures Commission would monitor any irregularity and would take appropriate action if necessary.

Service concession agreement

General

13. Notwithstanding that the Administration's paper had set out concrete proposals for fare reduction package and other matters concerning human resource integration, Ms LI fung-ying enquired whether MergeCo was obliged to implement the proposals as the MoU was non-binding in nature. SETW clarified that MTRCL would undertake a due diligence process to verify the information provided in the course of the merger negotiation. Should there be any irregularity discovered in the due diligence process, MTRCL would not be bound by the terms of the MoU.

14. On the duration of the service concession agreement, Mr LEE Wing-tat enquired about the rationale for setting the term at 50 years. Given its long life span, it would be difficult, if not impossible, to address any problems identified during the concession period. He opined that it would be more appropriate to shorten the duration of the agreement to 20 years, with an option to extend for a further period subject to an interim review.

15. Referring to the general principles as enshrined in the Basic Law that Hong Kong's existing system should remain unchanged for 50 years, Mr Albert CHAN remarked that the proposed duration of the concession agreement had already straddled beyond the 50 years as guaranteed under the Basic Law.

16. SFST said that railway operation involved long-term investment by railway corporations. Under the merger proposal, MTRCL would be responsible for the maintenance, improvement and replacement of the concession assets. If the duration of the service concession agreement was shortened to 20 years, MergeCo would not have sufficient time for its investment to pay off. Further, it took several years for MergeCo to reduce duplication and enhance efficiency of rail network to achieve the synergy effect and introduce service improvement plans. Having considered all the relevant factors, the Administration was of the view that the service concession should have a term of 50 years which would be co-terminus with the franchise of MergeCo. In case of serious default, the service concession agreement would be revoked.

Basis to calculate the upfront payments and other payments

17. Mr CHAN Kam-lam said that the Democratic Alliance for the Betterment and Progress of Hong Kong welcomed the merger proposal. He sought the Administration's clarification on how an upfront payment of $4.25 billion for the service concession and

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for acquisition of certain short-lived railway assets of KCRC was arrived at. He also asked whether KCRC would need to compensate MTRCL for the replacement of assets upon the expiry of the service concession agreement.

18. SFST introduced the two financial consultants who had been advising the Government on the merger deal for two years at a nominal fee of $1. He expressed appreciation for their efforts in this aspect. At the invitation of the Chairman, the two consultants from HSBC and Citigroup elaborated on the basis of calculation of the amount of payments under the merger proposal.

19. Mr Michael KERSHAW, Global Head of International Business Development of China, HSBC, said that in considering the terms and structure of the merger deal, the prime consideration was on the evaluation of cash flow generated from the KCR system, the operating costs and the commitments on maintenance, improvements and the renewal of the system for a period of 50 years. Projections on the cash flow over the concession period, including the fluctuations in patronage, had also been considered. All these factors had been taken into account to arrive at the amounts of the upfront payments, fixed annual payments and the pre-agreed set of sharing ratio under the revenue-sharing arrangement. The Government and MTRCL would need to discuss and agree on the anticipated investments over the service concession period. The term of the service concession agreement at 50 years was normal given the significant investment in railway projects. There would be no further compensation for MTRCL when the KCR system was returned to KCRC after 50 years except in relation to investments over the agreed investment programme, for which appropriate arrangements would be agreed.

20. Mr Frank SLEVIN, Managing Director and Chief Operating Officer, Asia Pacific Investment Banking, Citigroup, supplemented that the $4.25 billion upfront payment was arrived at, having regard to the need to strike a balance between the interests of all stakeholders. Mr SLEVIN and SFST pointed out that the upfront payment and the fixed annual payments were structured in such a way as to allow KCRC to repay its debts which would be matured over 2009-2013.

Property package

21. Citing that railway operation was not very profitable and had to be subsidized by means of property developments along the railway corridors, Ms Miriam LAU sought clarification on how a payment of $7.79 billion for the acquisition of KCRC's property and other related commercial interests was arrived at and whether the valuation had taken into account the intended use of the property developments for subsidization purpose. Ms LAU also enquired about the total gross floor area (GFA) in respect of the eight property developments under the property package.

22. In response, SFST advised that the gross floor areas of the residential development and commercial development of the eight property sites were 1 080 000 and 91 000 square metres respectively. Valuation for the procurement of the property development rights in respect of the eight property sites were assessed by independent

valuer. During the merger discussion, MTRCL had emphasized the importance of property development which could generate non-fare profit and provide a good patronage base for railway operation. Having considered the advice of the independent valuer, the Administration considered MTRCL's latest offer of $7.79 billion to purchase KCRC's properties as a package acceptable. As to whether the related property developments could generate profit for subsidizing railway operations in future, SFST said that given the uncertainty in the property market, it was premature to give an estimate, bearing in mind the timeframe for the related property developments had yet to be worked out.

23. Mr Ronny TONG said that rail merger should give rise to synergy which, in turn, should enable MergeCo to reduce its fares. He therefore queried why there was a need to include the proposed property package in the rail merger deal. Citing the 2004 Annual Report of KCRC, Mr TONG said that the assets of the corporation amounted to some $91 billion. Even after deducting the liabilities of some $31 billion, the net assets of the corporation still amounted to some $60 billion. Compared to the proposed financial terms for the rail merger which involved a payment of only $7.79 billion for the acquisition of KCRC's property and other related commercial interests, the merger deal was to the disadvantage of Hong Kong people who owned the assets of KCRC. On the other hand, the sharp rise in the share price of MTRCL indicated that the proposed terms were well received by the market. He therefore sought details on how the proposed financial terms were arrived at. He also requested the Administration to provide details of the remaining assets held by KCRC after the rail merger and their residual values.

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24. SFST clarified that the Government was not disposing of the assets of the KCR system. Under the service concession agreement, a right was granted to MTRCL to access and use certain KCRC's assets to operate the existing and new KCR railway lines under construction. Upon expiry or termination of the service concession, MergeCo was obliged to deliver back to KCRC a railway system that met the prevailing operating standards. Although the total and net book assets of KCRC amounted to some $90 billion and $60 billion respectively, the value of KCRC assets depended also on the actual financial performance and returns of the company. At present, the return on equity for KCRC was only about 1% to 2%. Regarding the proposed property package, this was part of the merger deal. The granting of property development rights to railway corporations for railway developments had all along been adopted by the Administration. He reiterated that the proposed payment of $7.79 billion for acquiring KCRC's property and other related commercial interests was adopted on the advice of independent valuer. For future property developments, MergeCo was still required to pay the full market value land premium to the Government. On the share price of MTRCL, SFST said that whilst rise in share price would benefit the 400 000 small investors of MTRCL, there remained a number of factors which would affect the future share value of MTRCL. Rise in share price of MTRCL did not mean that the merger deal was to the disadvantage of Hong Kong people who owned the assets of KCRC, it could be seen as that investors had full confidence in the future of MergeCo. He reiterated that the deal was fair and reasonable. In the end, it had to be accepted by

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Legislative Council and the minority shareholders of MTRCL.

25. Mr Albert HO expressed concern whether public interests were properly safeguarded when KCRC's property and other related commercial interests were disposed of at such low value to MTRCL. The inclusion of property package in the merger deal was intended to gain the support of minority shareholders of MTRCL. Notwithstanding the advice of independent valuer, in the absence of a proper tendering procedure, it would be difficult, if not impossible, for providing an accurate estimate on the value of the property development rights. Recalling that he had expressed serious reservation on the proposal to grant property development rights to MTRCL when discussing the Mass Transit Railway Bill in 2000, Mr HO pointed out that this had allowed MTRCL to reap handsome profits. As a listed company, MTRCL should not be granted the property development rights. If railway operation needed subsidy in one way or another, consideration should be given to setting up a dedicated fund. He asked whether the Administration would consider excluding the property package from the merger proposal.

26. SETW recapped that the rail and property model had been adopted in Hong Kong for a long time with great success; and a number of overseas and Mainland cities were considering to adopt a similar model for railway development. The advantage of this model was that land use development and railway development could be synchronized. Fare revenue alone might not be sufficient to finance new railway projects which required substantial investment, and property developments along railway corridors could help fill the funding gap of project implementation.

27. In response to the enquiry of Mr Albert HO on whether the rail merger could still proceed if the property package was taken out from the proposal, SFST replied that the premise that property development could generate huge profit for MTRCL was made on the assumption that the property market would always remain buoyant. However, if there was a slump in the property market in future, the present valuation of the property package would be seen to be on the high side. He further said that as the property package was an integral part of the merger proposal, it was unlikely that MTRCL would accept the revised terms if the property package was excluded from the rail merger proposal.

28. Dr YEUNG Sum said that the Democratic Party was concerned about the proposed terms of the rail merger which might be too favourable to MTRCL and its shareholders. Given that property developments along railway corridors could generate huge profits for railway corporations, the proposed acquisition of KCRC's property and other related commercial interests by MTRCL would no doubt receive support from small investors. However, it did not necessarily mean that the proposed sale would be to the best interest of the general public.

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29. SFST reiterated that the package proposal was a fair and balanced deal and was not in particular favourable to any party. It would bring overall benefits to the community as a whole. It also balanced the interests of all stakeholders, namely, the people of Hong Kong who owned the assets of KCRC, the passengers of the railways, the staff of the two corporations and the shareholders of MTRCL.

30. Mr Albert CHAN reiterated that the proposed merger package was to the advantage of MTRCL as it allowed the corporation to grasp huge profit at the expense of Hong Kong people who owned assets of KCRC. The proposed structure for the rail merger, which involved transfer of assets, had not been discussed by the public.

31. SFST did not agree that the proposed merger package was favourable to MTRCL. The proposed revenue-sharing arrangement would ensure that KCRC would enjoy the upside when the revenue from the KCR system increased. In deciding upon a means to effect the rail merger, the Administration had considered the benefits of the rail merger for the community. The proposed package had balanced the interests of the different stakeholders. During the concession period, MergeCo would be responsible for operating the integrated railway networks. This would include undertaking and funding maintenance, improvement and replacement of assets of the KCR system.

32. While supporting the merging of the two railway systems, Ir Dr Raymond HO opined that it was imperative for the Government to ensure that the package proposal was a fair and balanced deal and could also boost staff morale for the benefits of the general public. He queried about the rationale for pitching the concession period at 50 years. Given that many parts of the KCR system were newly commissioned or under construction, and these parts would see an increase in patronage and revenue some time after they were commissioned and in operation, he was worried that the present valuation could not reflect the actual value of the KCR system.

33. SFST noted the observation of Ir Dr Raymond HO. To avoid disposal of KCRC's assets at a severely diminished value, the Government had sought a structural solution under which KCRC could retain ownership of the assets, capture the upside of KCR railway's performance under a revenue-sharing mechanism and could get back a fully operational railway system at the end or upon early termination of the service concession.

34. Mr LEUNG Kwok-hung expressed objection to the proposed rail merger package and the acquisition of KCRC's property and other related commercial interests. He considered that the proposed rail merger was intended to deceive the public as KCRC and MergeCo would no longer be subject to public scrutiny. The fare reduction package was proposed to appease the public. While supporting the policy objective of promoting railway development, he considered that the property development rights should be disposed of through public tender but not private treaty grant. If KCR system could be transferred to MTRCL, a business conglomerate, in the present manner, then all other public transport and utilities could be privatized likewise which would be

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against the public interests. He also remarked that whilst the general public might be able to enjoy a small degree of fare reduction through cross subsidization by means of the granting of property development rights to railway corporations, they would be exploited in the end by high property prices whilst only allowing railway corporations to grasp huge profit from property sale.

35. SFST said that the remark made by Mr LEUNG Kwok-hung about the Administration's intention to deceive the public through the merger proposal was totally unfounded. He asked to put on record that the package proposal was a fair and balanced deal. As the majority shareholder of MTRCL, the Government was not a business conglomerate but had always worked for the interest of the general public.

36. Mr LEE Wing-tat remarked that the revenue from railway operations was rather stable but would not be great. But on the other hand, property developments could generate huge profit. To this end, he opined that in devising the proposed financial terms for the acquisition of KCRC's property and other related commercial interests, the Administration should adopt a revenue-sharing approach which was commonly adopted by other institutions such as Urban Renewal Authority in taking forward urban renewal projects. Given the uncertainties in the property market, adoption of a revenue-sharing approach would be fair to both sides.

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37. In response, SFST said that the property package was an integral part of the whole deal. After negotiation with MTRCL and taking into account the advice of the independent valuer, the Administration considered that MTRCL's latest offer of $7.79 billion to purchase KCRC's investment properties, property management business, and property development rights in respect of eight property sites as a package was acceptable. The Administration considered the present deal fair. MergeCo would have to pay the full market value land premium for property developments at the concerned property sites.

38. Mr LEE Wing-tat said the return on net fixed assets of KCRC for 2004 was just 1% which was much lower than the targeted return rate of 8% as announced by KCRC in 1990s. As railway operation was not attractive and profitable, the merger proposal must include the property package in order to solicit the support from the minority shareholders of MTRCL. If the property package was excluded, the minority shareholders of MTRCL would not support the merger proposal. As such, the merger proposal was a de facto property transaction. He requested the Administration to provide details on the evaluation of various options for the structure and the financial terms for the proposed merger of the MTR and KCR systems. It was imperative for the Government to assure members that all options had been fully examined and the present merger proposal was the most optimal one.

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Fare reduction

Extent of fare reduction

39. Notwithstanding that the railway fares would not be increased in the next 24 months counting from 11 April 2006, Mr LEE Cheuk-yan remarked that the general public could not gain much benefit from the proposed rail merger as the proposed fare reduction package would only take effect on Day One of the rail merger and the scope of reduction was rather limited. Given the time taken for dealing with the merger exercise, it was likely that soon after the rail merger, railway fares would be automatically adjusted upward based on the proposed formulaic approach for determining future fare adjustments. Worse still, future fare adjustments would not take into account public affordability. Given that the Legislative Council had been urging the two railway corporations to reduce their fares due to cumulative deflation over the past few years, he considered that there should be a minimum of a 20% fare reduction for all long-haul passengers and 10% for all short-haul passengers.

40. SETW said that the Administration had taken into account the public need in deliberating on the fare reduction package, and considered that priority should be accorded to long-haul passengers. Under the proposed fare reduction package, there would be a minimum of a 10% fare reduction for all passengers traveling on journeys with fares at $12 or above and a minimum of 5% fare reduction for all passengers traveling on journeys with fares between $8.5 and $11.9. Taking into account the benefits from abolition of second boarding charge and the global fare reduction, altogether 2.8 million daily rail trips would benefit from fare reduction on Day One of the rail merger. In response to Mr LEE Cheuk-yan's enquiry, SETW clarified that the commitment of the two railway corporations not to increase their fares for two years would count from the date of Government's announcement of the merger package, viz 11 April 2006.

41. Given that MTRCL would acquire the property development rights of the eight property sites, Mr LEE Wing-tat opined that profits from these property developments should provide room for further fare reduction by MergeCo. Further, the merger proposal would allow a better use of resources which, in turn, should enable MergeCo to reduce their fares at greater magnitude. Dr YEUNG Sum also asked the Administration whether the extent of fare reduction could be enlarged.

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42. SETW said that as railway operation could only generate a return of 1% to 2%, a general fare reduction of 10% for all passengers would impact adversely on fare revenue of MergeCo in the long run.

Railway lines excluded from fare reduction package

43. Stating support for the proposed merger in principle, Ms Miriam LAU agreed that long-haul passengers should be granted with greater assistance. However, she remarked that the proposed fare reduction package had neglected the interest of a group

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of East Rail (ER) passengers who needed to travel daily to and from Lo Wu due to increasing integration between Hong Kong and the Pearl River Delta Area. She asked the Administration to review the matter so that ER passengers traveling to and from Lo Wu could benefit from the fare reduction package, bearing in mind MTRCL would acquire property-related and commercial interests of KCRC which, in turn, could generate profits to enable the railway corporations to reduce railway fares.

44. With a greater integration of Hong Kong and the Pearl River Delta and closer liaison with the rest of the world, Mr Jeffrey LAM pointed out that exclusion of passengers travelling on ER to and from Lo Wu and the Airport Express Line (AEL) from the fare reduction package was not conducive to the integration of Hong Kong with other places. He requested the Administration to consider providing fare reduction for passengers on these two lines.

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45. Mr Abraham SHEK said that the Lo Wu fare was formulated in 1983 with an aim to lower the fares for other domestic services. As most of the passengers travelling on ER to and from Lo Wu were holiday-makers or on business trips, he supported that the Lo Wu fare be retained at the present level so that other ER passengers could enjoy a lower fare.

46. SETW explained that the Administration had considered whether Lo Wu fare should be reduced in the context of the rail merger exercise. In view that new cross-boundary transport facilities such as Lok Ma Chau Spur Line and Hong Kong-Shenzhen Western Corridor would be commissioned in the next two years, it would not be appropriate to review the Lo Wu fare in isolation at this stage. In considering the fares for cross-boundary transport services, the Administration would take into account the policy objective of providing passengers with reasonable choices whilst promoting healthy competition among different public transport modes. The AEL was not included in the proposed fare reduction package as it had its own unique fare structure and staff working on the airport island already enjoyed concessionary AEL fare in their daily commuting.

47. Mr LEE Wing-tat enquired whether the Light Rail Transit (LRT) was included in the fare reduction package. In response, SETW confirmed that LRT was not included taking into account that LRT passengers already enjoyed free interchange with West Rail and the LRT operation had been loss making. Mr LEE expressed grave dissatisfaction with the Administration's decision, which had totally neglected the needs and relative financial positions of residents in North West New Territories. As LRT had become a major transport means in the area, he strongly requested the Administration to consider reducing LRT fare in the context of the rail merger. The Administration took note of Mr LEE's request.

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48. In response to the Chairman's enquiry, SETW confirmed that apart from ER Lo Wu cross border line, LRT and AEL, passengers on other domestic railway lines would benefit from the fare reduction package.

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49. Noting that the fare structures of KCR and MTR systems were different, the Chairman was worried that after the rail merger, MergeCo might take the opportunity to revise upward the fares of KCR service so as to bring them in line with the MTR system. The Chairman cautioned that any change in the fare structure of KCR service would arouse grave public concern. He sought the Administration's comment on whether the existing fare structure of KCRC would be revised so as to bring it in line with that of MTR after the rail merger.

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50. In response, SETW said that the railway fares would be reset according to the proposed fare reduction package upon the rail merger.

Impact of merger on employees

51. Ms LI fung-ying pointed out that since the announcement of the rail merger proposal by the Government a few years ago, the staff side of the two railway corporations had been expressing grave concern about their job security and possible changes in employment terms and conditions after the rail merger. She was dissatisfied that despite the conclusion of the key terms for the rail merger, the interests of the staff side had not been adequately protected and there remained a lot of uncertainties to be faced by the serving staff. In this respect, she enquired about the concrete measures to ensure the job security of staff, including contract staff, and how the prevailing terms and conditions of employment of all serving staff could remain unchanged after the rail merger.

52. SETW said that she understood and appreciated the staff concerns over the rail merger. She pointed out that the two railway corporations had agreed that future staff arrangements would be handled fairly and equitably in the rail merger exercise, and they had already established special task forces to deal with the staff-related matters. MergeCo would provide job security to all frontline staff as it related to merger. As agreed between MTRCL and KCRC, there was a clear definition of frontline staff which meant "those full-time non-managerial staff who were employed regularly and directly in the operations and maintenance of trains, stations, buses and vehicles; infrastructure maintenance; stores operations and security operations. Non-managerial staff referred to staff below Grade MG1 in the case of MTRCL and staff below Grade 8 in the case of KCRC, who were employed on either continuous terms or contract terms for a duration of two years or more". All serving staff of the two corporations would be employed by MergeCo on their prevailing terms and conditions upon the rail merger.

53. Ms LI Fung-ying sought an undertaking from the Administration that the employment terms and conditions of all serving staff would not be worse off as a result of the rail merger. SETW said that under the merger package, MergeCo would adopt a "total package" approach in considering employment terms and conditions of staff and the intention was that the revised terms and conditions would be comparable to the existing ones in overall terms. The two corporations would conduct further studies on the setting of one set of terms and conditions for all serving staff after the rail merger and they would consult staff during the process.

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54. Noting that the frontline staff did not include the management and professional staff, Ir Dr Raymond HO expressed concern that the management and professional staff might be affected as a result of the rail merger and they would be forced to leave Hong Kong in the end. He cautioned that it was of paramount importance to retain talents in Hong Kong for sustainable developments. He asked whether the Administration had measures to ensure the employment protection of professionals and management staff.

55. SETW said that the merger proposal had provided protection of job security for frontline staff of the two railway corporations. The two corporations had estimated that there would be a net increase of 1 300 staff vacancies in the first three years arising from new jobs created due to business growth of MergeCo as well as retirement and turnover, which exceeded the estimated overall staff synergy of 650 – 700 full-time equivalents which was expected to be achieved over a number of years as a result of the rail merger. MergeCo needed flexibility in the deployment of management and professional staff. Upon the rail merger, the relative strength of MTRCL and KCRC could supplement each other. MergeCo would have new opportunities to expand into the Mainland and international market and as a result would continue to keep and recruit talents.

56. Mr LEE Cheuk-yan opined that in the transition to a unified set of terms and conditions for the staff, the staff side should be given a choice to stay in the existing system or switch to the new system. In response, SETW said that there were some differences between the terms and conditions of the staff of the two railway corporations such as the working hours which should be aligned and therefore a unified system should be adopted in MergeCo. The two corporations would consult their staff on any new arrangement.

57. Ms LI Fung-ying sought details about the procedures and guidelines for the selection of staff into positions in MergeCo after final approval of the rail merger. She was worried that the employment opportunity and the terms and conditions of the serving staff would be adversely affected in the course of the selection process.

58. SETW pointed out that the two railway corporations would work out details of the selection process after thorough discussions with their staff. She further advised that staff were important assets of the railway corporations. Under the merger package, job security for all frontline staff of the two corporations would not be affected as it related to the merger. The two corporations had agreed on the definition of frontline staff for the purpose of the merger exercise. The two corporations estimated that there would be a net increase in staff vacancies available in the first three years of the rail merger after taking into account the estimated staff synergies. Therefore in overall terms, there would be more career development opportunities to staff after the rail merger.

Action

Admin 59. At Mr LEE Cheuk-yan's request for a detailed breakdown of the 1 300 new vacancies and the overall staff synergy of 650 – 700 full time equivalents, which would be achieved as a result of the rail merger in terms of their job title, job nature, and job skills required, the Administration agreed to provide written information.

New railway projects

60. Mr CHAN Kam-lam enquired about the progress of SCL as residents in Whampoa and Kowloon City had been asking for the early implementation of the project for years.

61. Mr Ronny TONG also sought details on the implementation programme of SCL. On the design of SCL, he also expressed concern that MTRCL might take the opportunity to revise the alignment of SCL and reduce the railway stations which might cause inconvenience to the public.

62. SETW explained that the SCL project was a committed railway project. In 2002, the project was awarded to KCRC after a competitive bidding. The merger discussion involved a study on interchange arrangement for SCL and the possible alignments so that the optimal efficiency of railway operation could be achieved. Details of SCL project were near finalization but some stations and alignment were subject to other planning and development, such as the review of the planning for South East Kowloon Development. SETW said that the Administration would brief the Transport Panel on SCL later this year.

63. Dr YEUNG Sum enquired whether the synergy created from the merger could expedite the decision to construct the South Island Line (SIL) as MergeCo might require less funding support from the Government on the project. In response, SETW said that the Administration was still considering MTRCL's SIL proposal. In studying any individual new railway project proposals, the Administration would take into account the passenger demand for the new lines and other relevant factors on a case-by-case basis.

Way forward

64. Mr Albert CHAN suggested that the Transport Panel and the Financial Affairs Panel should further examine various aspects of the merger proposal, namely, property valuation, fare reduction package and fare adjustment mechanism, and protection of employees. Separate meetings should be arranged to deal with individual issues.

65. SETW advised that the Administration hoped to expedite the merger process so that the passengers on the MTR/KCR systems could enjoy the fare reduction benefits as soon as possible. The Administration would shortly introduce the relevant legislative amendments into the Council.

Action

66. Given the significant public interests involved in the proposed rail merger, members agreed that the Transport Panel and the Financial Affairs Panel would continue to follow up on the related issues. After deliberation, members agreed that the staff-related issues arising from the rail merger should be discussed at the meeting of the Transport Panel scheduled for 28 April 2006. Representatives of the staff side should be invited to the meeting to give views on the matter. As a result of the change, the item on "Corporate Governance of Kowloon-Canton Railway Corporation", which had originally been scheduled for discussion at the meeting on 28 April 2006, would be deleted from the agenda. The Chairman would liaise with the Chairman of the Financial Affairs Panel on further meetings to study other aspects in relation to the merger proposal.

III Any other business

67. There being no other business, the meeting ended at 1:05 pm.

Council Business Division 1
Legislative Council Secretariat
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