

**Legislative Council Panel on Transport
Subcommittee on Matters Relating to Railways**

**Proposed Arrangements
for Taking Forward
the Hong Kong Section of
Guangzhou-Shenzhen-Hong Kong Express Rail Link**

PURPOSE

MTR Corporation Limited (“the Corporation”) has reached an agreement (“XRL Agreement”) with HKSAR Government (“the Government”) on the proposed arrangements for taking forward the Hong Kong section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link Project (“the Project”) covering, amongst other things, the proposed funding of the cost increase. As the project manager, the Corporation has been requested by the Government to provide details of the proposed arrangements to the Committee.

BACKGROUND

2. The Project is an express rail link connecting Hong Kong with Shenzhen, Dongguan, and Guangzhou which will become part of the National High-speed Railway Network. Funding for the construction of the Project (total amount of HK\$66.8175 billion in money-of-the-day (“MOD”) prices) was approved by the Finance Committee of Legislative Council (“LegCo”) on 16 January 2010. Of this amount, a sum of HK\$65 billion was allocated by the Government to the Corporation to carry out the construction and commissioning of the Project in

accordance with an “Entrustment Agreement for the Construction and Commissioning of the Project” (“Entrustment Agreement”) dated 26 January 2010.

3. Under the Entrustment Agreement, the Corporation acts as the project manager of the design, construction and commissioning of the Project and is obliged to act in accordance with its own management systems and procedures in, among other areas, project management and procurement. A total of 42 major construction contracts¹, together with other minor contracts, have been awarded to contractors for the delivery of the Project. As the project manager, the Corporation oversees the overall works as well as works undertaken under each contract and closely monitors and controls the associated costs. Whilst the performance of respective contractors varies, the Corporation works diligently with each of them to resolve both technical and commercial issues with the objective of identifying solutions which are best for the Project from both a cost and a delivery perspective.

4. As reported to the Subcommittee on Matters Relating to Railways under the LegCo Panel on Transport (“RSC”) in July 2015 (LegCo paper: CB(4)1228/14-15(01)), the Corporation submitted a revalidation of the Programme to Complete (“PTC”) and Cost to Complete (“CTC”) for the XRL project to the Government on 30 June 2015. At that time, it was estimated that the project completion would be in Q3 2018, which includes a 6-month contingency period, and it was estimated that the CTC would be HK\$85.3 billion, including a contingency amount of HK\$2.1 billion.

¹ Major construction contract refers to an individual contract with a value above HK\$50 million.

5. As at 30 September 2015, the cumulative expenditure under the awarded contracts was HK\$49.90 billion. Details of the expenditure and claim situation of the Project are shown at Annex I.

REVIEW OF THE REVISED CTC AND PTC

6. The Government has sought further information from the Corporation and, together with its consultants, conducted a detailed review of the revalidated CTC and PTC submitted by the Corporation. As a result of such review, the latest CTC has been reduced by HK\$880 million from HK\$85.3 billion to HK\$84.42 billion. The adjustments can be reflected in three major areas:

		Revalidated CTC (30/06/2015) (HK\$ million)	Reduction (HK\$ million)	Latest CTC* (30/11/2015) (HK\$ million)
(a)	Contingency**	2,100	150	1,950
(b)	Additional Project Management Cost (PMC)	1,940	186#	1,754
(c)	Fitting out of 5 additional tracks to cater for future demand (“Day 2 Works”))##	544	544	0
	Total		880	

* Latest CTC is HK \$84.42 billion

**Includes adjustments to a small number of other items

Of which, HK\$36 million is related to the Day 2 Works

Details in paragraph 9

7. Contingency - Since time has elapsed and physical works have made progress since the Corporation submitted the revalidated CTC to Government on 30 June 2015, and as the Project is 74.6% complete up to 31 October 2015, after discussion, Government and the Corporation agreed on a net reduction of HK\$150 million, as a result of a reduction in the Project cost contingency and adjustments to a small number of other items.

8. Additional PMC - The PMC put forward by the Corporation to the Government on 30 June 2015 was devised from a bottom-up approach, based on costs, while Government's consultant adopted a top-down approach in its assessment. We have now agreed to reduce the additional PMC by HK\$186 million, which includes a HK\$36 million reduction related to the Day 2 Works.

9. Day 2 Works - It was always the plan under the PTC that the final fitting out of the tracks in the terminus would be delivered in two phases, i.e. 10 fully fitted out tracks as required to meet initial operating requirements and the remaining five tracks only when passenger demand justifies (Day 2 Works). As there is considerable uncertainty over the timing of the Day 2 Works, it has been agreed that all such works should be taken out, resulting in a HK\$544 million reduction in the CTC. It should be noted that all the civil construction works other than track fitting out works relating to Day 2 Works will be completed as part of the agreed CTC and PTC.

10. As at end October 2015, tunnel excavation was 99.7% complete, the West Kowloon Terminus, the most complicated and critical part of the works, was 62.5% complete and overall, 74.6% of the works have been completed. The latest CTC of HK\$84.42 billion has been reviewed by the Corporation's independent experts as well as the Government and

its consultants. The Corporation is therefore confident of achieving the latest CTC of HK\$84.42 billion. We continue to work towards the target of commencing commercial operation in Q3 2018.

THE XRL AGREEMENT

11. The Express Rail Link is vital to Hong Kong as it will bring direct benefits in terms of time savings and enhanced ease of travel; it will also bring benefits in terms of fostering trade, professional services and other economic activities. Connectivity is an important factor for achieving growth and development. Failing to improve our infrastructural connectivity will undermine Hong Kong's long term competitiveness.

12. The Project is also very important to the Corporation. The Corporation has been successfully involved in the construction and operation of railway systems not only in Hong Kong, but also abroad. As the Project Manager, it has every interest in the successful delivery of the Express Rail Link. Furthermore, the Corporation has undertaken the project management of the Express Rail Link on the understanding that it will be invited to undertake the operation of the Express Rail Link under the concession approach.

13. It is therefore both in the public interest and the Corporation's interest to find a solution to the additional funding required to complete the Project. After detailed discussions, the Government and the Corporation signed the XRL Agreement on 30 November 2015, which sets out proposed arrangements for taking forward the Project (including dealing with the cost increase).

14. The XRL Agreement provides, among other things, that:
- (i) Government shall bear and finance the Project cost up to HK\$84.42 billion (an increase of up to HK\$19.42 billion (Current Cost Increase) from the original Project cost estimate of HK\$65 billion);
 - (ii) the Corporation shall bear and finance any Project costs exceeding HK\$84.42 billion (if any) (except in limited circumstances specified in the XRL Agreement);
 - (iii) the Corporation shall pay a Special Dividend of HK\$4.40 per share in aggregate, in two equal tranches (of HK\$2.20 per share in each tranche). These are expected to be paid in the second half of 2016 and the second half of 2017 respectively (total dividend to be paid of approximately HK\$25.76 billion);
 - (iv) other terms of the Entrustment Agreement previously entered into relating to the Project between Government and MTR remain, except for amendments required to reflect the XRL Agreement's proposed arrangements; and
 - (v) Government to reserve its right to seek a determination of the Corporation's responsibility (if any) under the existing Entrustment Agreements for the Current Cost Increase through arbitration, after the commencement of commercial operations on the Project.

(A Summary of the XRL Agreement is attached as Annex II.)

15. The proposed arrangements contained in the XRL Agreement are conditional on (i) LegCo approval of the additional funding, to be sought by the HKSAR Government, and (ii) approval by Independent Shareholders of the Corporation at an extraordinary general meeting to be

held on or about 1 February 2016; and will become effective only when such conditions are satisfied. If the conditions are not satisfied prior to 30 September 2016 (or earlier, if a termination of the Entrustment Agreement is commenced prior to that date), the arrangements will not be implemented.

16. The XRL Agreement is specifically tailored to address the particular circumstances of the Project and will not serve as a precedent for the manner in which any other project will be addressed.

17. While the Project has encountered deviations from the original commissioning schedule and approved funding due to a number of reasons previously announced, the Government and the Corporation remain jointly aligned and committed to the Project. We believe the proposed arrangements in the XRL Agreement provide a pragmatic and viable solution to take forward and complete the Project. The key elements of the proposed arrangements, including the Corporation's commitment to bear Project costs exceeding the latest CTC of HK\$84.42 billion and the payment of the Special Dividend to all shareholders (with the total amount to be received by the Government being approximately equal to the Current Cost Increase of HK\$19.42 billion), are major steps to provide the impetus for an amicable resolution. The Agreement will become effective only if approved by the Corporation's independent shareholders and LegCo as stated in paragraph 15.

18. The payment of the Special Dividend will benefit all of the Corporation's shareholders. Currently the Corporation has a strong balance sheet and after payment of the Special Dividend, the Corporation's financial position will remain healthy and we intend to continue pursuing future capital investment projects as well as our intention to maintain our progressive dividend policy.

WAY FORWARD

19. As a result of the negotiations between Government and the Corporation, the XRL Agreement takes into account the interests of different stakeholders, and provides a clear road map to bringing this very important project forward to fruition. It will become effective only if approval is granted by Independent Shareholders at an extraordinary general meeting of the Corporation; and LegCo approval is given for Government to fund the cost increase.

20. As always, the Corporation will continue to use its best endeavours and will work closely with its contractors to deliver the Project in line with the latest PTC and CTC.

21. Additional funding has to be provided by July 2016 in order to continue with the Project. Should it become apparent that no additional funding is provided, Government may instruct the Corporation to issue a suspension notice to the contractors in advance in order to keep the total cost of the Project within the amount originally allocated by the Government. Based on the current cash flow estimate, this may occur some time before July 2016.

22. The Government has reserved its right under the Entrustment Agreement to seek a determination of the Corporation's responsibility under the existing Entrustment Agreements (if any) for the Current Cost Increase. Any such arbitration will only take place after the commencement of commercial operations on the Express Rail Link. If the arbitrator determines that, but for the liability cap in the Entrustment Agreement, the Corporation's responsibility for the Current Cost Increase would exceed the liability cap, then the Corporation will convene another extraordinary general meeting of the Corporation to seek Independent

Shareholders' approval to bear any liability in excess of the cap.

MTR Corporation Limited
November 2015

Annex I – Financial Expenditure

Expenditure report ending 30 September 2015

Table 1 – Situation of Expenditure

	Awarded contract sum for the contracts (\$ million)	Cumulative expenditure under the awarded contracts (\$ million)
Railway Tunnels	22,470.7	27,138.3
West Kowloon Terminus ("WKT")	14,595.8	16,350.5
Electrical and Mechanical ("E&M") Works	8,166.1	6,407.0
Total	45,232.6	49,895.8

Table 2 – Situation of substantiated claims

	Claims resolved			Claims unresolved		
	Number	Amount claimed originally* (\$ million)	Amount awarded (\$million)	Number	Amount claimed* (\$ million)	Interim award (\$ million)
Railway Tunnels	82	2,324	1,284	366	9,328	1,822
WKT	46	247	187	290	11,188	2,044
E&M Works	2	0	0	66	3,124	136
Total	130	2,571	1,471	722	23,640	4,002

*Amount stated in the contractor's detailed claim report.

2. As at 30 September 2015, the Corporation had received 852 substantiated claims and the amount claimed in total was approx. \$26.21 billion, representing 57.9% of the awarded contract sum for the contracts. The Corporation has been discussing the details of the claims with the contractors concerned, and will thoroughly assess the amount claimed. The Corporation will process each claim in a prudent manner, and the contractors will have to provide sufficient justifications and information. As at 30 September 2015, 130 cases had been resolved and about \$1,471 million had been awarded, representing about 3.25% of the awarded contract sum for the contracts. Subject to the needs of individual works and progress of the relevant assessments and discussions, interim awards amounting to about \$4,002 million have been made for some cases.

Annex II - Summary of the XRL Agreement

Summary of the XRL Agreement

A. *Financing of Current Cost Overrun*

Government shall bear and finance the Current Cost Overrun.

B. *Financing of Further Cost Overrun*

The Company shall bear and finance the Further Cost Overrun, if any. The Company shall have no obligation to bear and finance such portion of the Further Cost Overrun that:

- (i) results from any change in any ordinance or subsidiary legislation enacted or made after the execution of the XRL Agreement which affects directly the Express Rail Link Project and/or the Entrustment Activities; or
- (ii) (a) comprises any costs or expenses (including costs and/or expenses arising directly or indirectly from the suspension and/or any subsequent re-commencement of the relevant Third Party Contracts including, without limitation, any additional costs and expenses in respect of sub-contractors of any tier, suppliers and workers) arising as a direct or indirect result of the Company complying with a written notice from Government instructing the Company to commence suspending Third Party Contracts; or (b) results from the occurrence of a force majeure; or (c) results from the suspension or termination of the EA2 otherwise than as permitted in the paragraph immediately below.

During the period when the Company is bearing and financing the Further Cost Overrun, Government shall not suspend or terminate the Express Rail Link Project and/or EA2 except as a result of the Company breaching EA2 provided Government does so in accordance with EA2.

If the Company becomes aware that the Entrustment Cost will exceed HK\$84.42 billion, it shall use its best endeavours to procure the agreement of relevant Third Parties that:

- (a) such Third Parties will not seek to enforce their rights under the Deed Poll to receive payment from Government of amounts of the Entrustment Cost (if any) that form part of the Further Cost Overrun; and
- (b) such Third Parties will seek payment from the Company of any amount of the Entrustment Cost that forms part the Further Cost Overrun.

In the event that, notwithstanding B.(a) and (b) immediately above, Government is

required to, and does, pay a Third Party for an amount of the Entrustment Cost that forms part of the Further Cost Overrun, the Company shall, as soon as reasonably practicable, indemnify Government for such amount paid by Government (excluding any amount referred to in B.(i) or (ii) above) provided Government has paid such amount in accordance with the Deed Poll and EA2.

C. *The Special Dividend*

The Company shall pay the Special Dividend of HK\$4.40 in aggregate per Share as an interim dividend.

The Special Dividend shall be paid in two equal tranches:

- (i) the first tranche will be paid on a date which will be determined by the Board and will be announced by the Company in accordance with the Listing Rules (being a date which is within a reasonable period following Completion) to Shareholders whose names appear on the Register on a date which will be determined by the Board and will be announced by the Company in accordance with the Listing Rules; and
- (ii) the second tranche will be paid on a date which will be determined by the Board and will be announced by the Company in accordance with the Listing Rules (being approximately 12 months after payment of the first tranche of the Special Dividend referred to in C.(i) above) to Shareholders whose names appear on the Register on a date which will be determined by the Board and will be announced by the Company in accordance with the Listing Rules.

D. *EGM*

The Company shall convene an EGM with a view to obtaining the Independent Shareholder Approval.

E. *Cost Overrun Arbitration*

Government reserves the right to refer the question of the Company's liability (if any) under EA1 and EA2 for the Current Cost Overrun (including any question Government may have regarding the validity of the Liability Cap) to arbitration in accordance with the arbitration provisions in EA2, save that any such referral will take place after the commencement of commercial operations on the Express Rail Link and will not require a prior referral to the senior executives committee or to mediation (as contemplated in EA2).

F. *Liability Cap*

If the Arbitrator does not determine that the Liability Cap is invalid and determines that, but for the Liability Cap, the Company's liability under EA1 and EA2 for the Current Cost Overrun would exceed the Liability Cap, then the Company shall:

- (i) bear such amount as is awarded to Government up to the Liability Cap;
- (ii) seek the approval of its Independent Shareholders for the Company to bear the Excess Liability; and
- (iii) if the approval of the Independent Shareholders referred to in F. (ii) immediately above is obtained, pay the Excess Liability to Government.

G. Conditions

- (i) The Arrangements (including the payment of the Special Dividend) are conditional on:

- (a) Independent Shareholder Approval being granted; and
- (b) LegCo Approval being granted,

prior to the Back Stop Date and will become effective when such conditions are satisfied.

- (ii) In the event that:

- (a) an alternative solution (as referred to in EA2) which is satisfactory to Government and the Company is not implemented; and
- (b) Government determines that the suspension of one or more Third Party Contracts in accordance with their terms will have to commence in order that the Entrustment Cost does not exceed HK\$65 billion,

Government may instruct the Company by written notice to commence the suspension process referred to in G.(ii) immediately above and the Company will, as soon as reasonably practicable, comply with such instruction.

- (iii) In the event that, as a direct or indirect result of the Company complying with a written notice from Government referred to immediately above, any additional costs or expenses arise (including costs and/or expenses arising directly or indirectly from the suspension and/or any subsequent re-commencement of the relevant Third Party Contracts including, without limitation, any additional costs and expenses in respect of sub-contractors of any tier, suppliers and workers), Government shall bear and finance such costs and expenses (and the Company shall have no responsibility whatsoever to bear and finance any such costs and expenses).

- (iv) Unless the Company receives a written notice from Government, the Company shall not commence suspending any Third Party Contract, for the purpose of ensuring that the Entrustment Cost does not exceed HK\$65 billion (and shall continue to administer the Third Party Contracts in such circumstances).

- (v) The Company's liability to Government arising out of, or in connection with G.

(ii) and (iv) above shall be subject to the Liability Cap.

H. Amendments to EA2

Certain amendments shall be made to EA2 to reflect the arrangements contained in the XRL Agreement, including:

- (i) an increase in the Project Management Cost payable to the Company to HK\$6.34 billion; and
- (ii) the Revised Programme.

I. Integrated Package

The Arrangements constitute an integrated package of terms.

J. No Precedent

The XRL Agreement and the Arrangements are specifically tailored to address the particular circumstances of the Express Rail Link Project and shall not serve as a precedent or create any expectations for the manner in which any other project will be addressed.

“Arbitrator”	means the arbitral panel appointed, in accordance with EA2, for the purposes of the Cost Overrun Arbitration (if any);
“Arrangements”	means all the arrangements in aggregate contained in the XRL Agreement which, together, form an integrated package of terms;
“Associates”	has the meaning given to that term in the Listing Rules;
“Back Stop Date”	means the earlier of (i) the date of a notice to terminate EA2 that may be served by the Company on Government under EA2; and (ii) 30 September 2016;
“Board”	means the board of Directors of the Company;
“Companies Ordinance”	means the Companies Ordinance (Cap. 622 of the Laws of Hong Kong);
“Company”	means MTR Corporation Limited;
“Completion”	means the date on which the XRL Agreement and the Arrangements become fully unconditional and effective in accordance with the XRL Agreement following the satisfaction of the conditions set out in the XRL Agreement as

	contemplated in Section G of the Appendix;
“Cost Overrun Arbitration”	means an arbitration (if any) commenced in accordance with EA2 to determine the Company’s liability (if any) for the Current Cost Overrun under EA1 and EA2;
“Current Cost Overrun”	means that portion of the Entrustment Cost (up to a maximum of HK\$84.42 billion) that exceeds the Project Control Total;
“Deed Poll”	means the deed poll executed by Government on 26 January 2010;
“Director”	means a member of the Board
“Dollars” or “HK\$”	denotes the lawful currency of Hong Kong;
“EA1”	means the preliminary entrustment agreement for the design of, and site investigation and procurement activities in relation to the Express Rail Link between Government and the Company dated 24 November 2008;
“EA2”	means the entrustment agreement for the construction and commissioning of the Express Rail Link between Government and the Company dated 26 January 2010;
“EGM”	means a general meeting of the Shareholders convened in accordance with the Listing Rules and the Companies Ordinance;
“Entrustment Activities”	has the meaning given to that term in EA2;
“Entrustment Cost”	means the total cost of the Entrustment Activities under EA2;
“Excess Liability”	means the amount of the Company’s liability (if any), for the Current Cost Overrun, determined by the Arbitrator under the Cost Overrun Arbitration that exceeds the Liability Cap;
“Express Rail Link” and “XRL”	the Hong Kong Section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link;
“Express Rail Link Project”	means the project of constructing and commissioning the Express Rail Link;
“FSI”	means the Financial Secretary Incorporated (incorporated under the Financial Secretary Incorporation Ordinance (Cap.1015 of the Laws of Hong Kong));

“Further Cost Overrun”	means the amount of the Entrustment Cost (including Project Management Cost), if any, that exceeds HK\$84.42 billion;
“Government”	means the Government of Hong Kong;
“Hong Kong”	means the Hong Kong Special Administrative Region;
“Independent Shareholders”	means Shareholders of the Company excluding the FSI and any Associates of the FSI and/or Government;
“Independent Shareholder Approval”	means the approval of the XRL Agreement and the Arrangements given by the Independent Shareholders at an EGM;
“LegCo”	means the Legislative Council of Hong Kong;
“LegCo Approval”	means the approval by LegCo (or the relevant committee(s) thereof) of the additional funding required for the Current Cost Overrun in order for Government to be able to perform its obligations under the XRL Agreement and the Arrangements;
“Liability Cap”	means the limit on the Company’s liability contained in Clause 4.11 of EA2;
“Listing Rules”	the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited;
“Project Control Total”	means HK\$65 billion;
“Project Management Cost”	means the amount payable by Government to the Company pursuant to EA2 (as amended by the XRL Agreement) and referred to therein as the “Project Management Cost” (as the same is increased in accordance with EA2, as contemplated in Section H of the Appendix);
“Register”	means the register of Shareholders kept by the Company in accordance with the Companies Ordinance;
“Revised Programme”	means the revised programme for the completion of the XRL Project which the Company reported to Government on 30 June 2015;
“Share”	means an issued share in the share capital of the Company;
“Shareholder”	means the holder of a Share;
“Special Dividend”	means a special dividend in the aggregate amount of

HK\$4.40 per Share;

“Third Party” has the meaning given to that term in EA2;

“Third Party Contract” has the meaning given to that term in EA2;

“XRL Agreement” means the Deed of Agreement in relation to the Express Rail Link between Government and the Company dated 30 November 2015.