立法會
Legislative Council

LC Paper No. CB(1)1309/99-00
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Bills Committee on
Mass Transit Railway Bill

Minutes of meeting
held on Friday, 10 December 1999, at 10:45 am
in Conference Room A of the Legislative Council Building

Members present : Hon Mrs Miriam LAU Kin-yee, JP (Chairman)
Hon HO Sai-chu, SBS, JP
Hon Cyd HO Sau-lan
Hon Edward HO Sing-tin, SBS, JP
Hon LEE Cheuk-yan
Hon NG Leung-sing
Hon Ambrose CHEUNG Wing-sum, JP
Hon CHAN Wing-chan
Hon CHAN Kam-lam
Hon SIN Chung-kai
Hon Andrew WONG Wang-fat, JP
Hon Howard YOUNG, JP
Hon Andrew CHENG Kar-foo
Hon FUNG Chi-kin

Members absent : Hon Kenneth TING Woo-shou, JP
Hon Albert HO Chun-yan
Ir Dr Hon Raymond HO Chung-tai, JP
Hon Eric LI Ka-cheung, JP
Hon Mrs Selina CHOW LIANG Shuk-yee, JP
Hon Ronald ARCULLI, JP
Hon CHAN Yuen-han
Hon Bernard CHAN
Hon LAU Chin-shek, JP
Hon LAU Kong-wah
Dr Hon TANG Siu-tong, JP

Public officers : **Transport Bureau**

attending

Mr Kevin HO
Deputy Secretary for Transport (1)

Mr Thomas CHOW
Deputy Secretary for Transport (4)

Mr Roy TANG
Principal Assistant Secretary for Transport (3)

Finance Bureau

Mr Martin GLASS
Deputy Secretary for the Treasury (2)

Miss Jenny YIP
Principal Assistant Secretary for the Treasury (I)

Department of Justice

Mr Jonothan ABBOTT
Senior Assistant Law Draftsman

Ms Betty CHOI
Senior Government Counsel

Attendance by invitation : **MTR Corporation**

Mr Clement KWOK
Finance Director

Mrs Miranda LEUNG
Corporate Relations Manager

N M Rothschild & Sons Limited

Mr Simon LINNETT
Managing Director

Mr Kelvin CHAU
Director

Clerk in attendance : Mr Andy LAU
Chief Assistant Secretary (1)2

Staff in attendance : Miss Connie FUNG
Assistant Legal Adviser 3

Miss Irene MAN
Senior Assistant Secretary (1)6

I Meeting with the Administration
(LC Paper No. CB(1)566/99-00(01) and (02))

The Chairman advised that two more submissions on the Bill had been received since the last meeting and circulated to members for information. She also drew members' attention to the list of follow-up actions and the information paper on "Regulatory Formulae" provided by N M Rothschild & Sons Limited.

2. The Deputy Secretary for Transport(1) (DS for T(1)) introduced Mr Simon LINNETT to members. Mr LINNETT was the Managing Director of N M Rothschild & Sons Limited, and possessed internationally-recognized experience in the privatization process of many public utilities in the United Kingdom (UK), such as telecommunications, gas, water, electricity and railway.

3. At the invitation of the Chairman, Mr LINNETT briefed members on the privatization of public utilities in UK. He said that many public utilities in UK were absolute monopolies. They were sold as mature business whose profiles were expected to change little after privatization, and were all majority sold to shareholders. Since these public service industries were economically inefficient, the privatization process was aimed at improving the efficiency of these businesses through the regulatory formula “Retail Price Index minus X” (RPI-X) in which RPI was the same as the “Consumer Price Index” (CPI) known in Hong Kong. The formula regulation worked well in the transition of the publicly-owned businesses to the commercial sector.

4. However, Mr LINNETT pointed out that the regulatory regime also had side effects. The increased cost of capital and uncertainty in the equity markets added pressure on fares. Moreover, the five-year review process distracted the attention of the management from the operation of the business. The review process stunted the regular efficiency improvement as companies tended to store up efficiencies to be secured immediately after a review. Management often focused on "beating the regulator" rather than on improving the operating performance of the business. As a result, most businesses sought to reduce their exposure to their regulated business and the best energies were devoted to the management of non-regulated activities.

5. Mr LINNETT pointed out that the UK experience under the formula regime showed that competition, rather than artificial regulation, was the best approach in

regulating monopoly businesses. The design of the regulatory regime for the privatized MTRC should be studied in the wider context of competiton amongst different transport modes. Unlike the UK railway, he remarked that the railway operated by the MTR Corporation was a young and growing business in Hong Kong and the Corporation was also operating under a competitive environment with many transport alternatives along its routes. While the fare regulatory regime introduced to the UK railway aimed at moving the business forward after privatization, MTRC had been established in a commercial environment for many years and had proven to be a successful business. He was of the view that the proposed introduction of fare control on MTRC was a step backwards because MTRC was already very efficient in its operations and provided good quality service. It was one of the best railways in the world and demonstrated the success of fare autonomy. The proposal would only add unnecessary cost and unrealistic commercial pressure on the already successful and efficient railway operations.

Fare determination mechanism

6. Given that the situation in UK was different from that in Hong Kong, Mr CHAN Kam-lam agreed that the CPI-X formula might not be applicable to Hong Kong. However, since the local railway service was quite dominant as it contributed 40% to the transport market and faced very limited competition, Mr CHAN considered that the absence of a fare regulatory framework would not be acceptable by the public. He sought Mr LINNETT's view on the feasibility of fare regulation by an independent and public body with integrity such as the Transport Advisory Committee (TAC).

7. In response, Mr LINNETT pointed out that the decision maker of the business could rest either with the regulator or the business operator. The former did not have direct responsibility for the delivery of service while the latter had to take care of the business operation. If TAC was to act as a regulator and be responsible for fare determination, the regime would become very rigid and less responsive to the changing environment and need of society. The regulatory regime would also affect investors' participation which was critical in railway development. The Financial Director/MTRC (FD/MTRC) clarified that MTRC had a market share of 25.7% instead of 40% in the transport sector in Hong Kong.

8. Mr CHAN Kam-lam elaborated on his proposal. TAC would only act as an independent and authoritative body to assess the Corporation's service and business development in line with the fare levels, not a regulator imposing control on all business decisions. He considered TAC a better regulator than the rigid formula CPI-X or the Legislative Council (LegCo), and reiterated that a regulatory framework was essential to maintain reasonable fare levels and operational standard. In response, Mr LINNETT said that the Government could always monitor the performance of the Corporation by amending the ordinance concerned and imposing sanction on unsatisfactory performance. The experience of MTRC proved that it had operated effectively in a commercial environment and consultation would be undertaken in any proposed fare increase. The Consumer Council also confirmed that MTRC was

operating in a competitive environment which had served as the best form of regulation.

9. Noting that different political parties of LegCo were advocating different fare regulatory regimes, Mr LEE Cheuk-yan sought Mr LINNETT's clarification on whether it was a basic element in the process of privatization for MTRC to have fare autonomy with respect to its business goals. Mr LINNETT advised that privatization aimed at bringing success to business; moving away from fare autonomy would affect business achievements and the privatization process. This was an important, but not an absolute or fundamental, part of privatization. FD/MTRC supplemented that the considerations for achieving the best for the business should prevail even without privatization. These considerations included the existing financing, loans, bank facilities, bonds and operations of the business.

10. Given that fare autonomy was of such importance, Mr LEE Cheuk-yan doubted if the Corporation's consultation process with TAC, the LegCo Panel on Transport and passengers after privatization would serve any useful purpose. Mr LINNETT advised that it would depend on the basis on which the consultation was conducted and whether the consultation entered into the proper spirit. Considerations would also be given to the view of investors since all businesses had the right to determine their prices according to consumers' acceptability. FD/MTRC added that an information paper would be circulated to members shortly detailing the
MTRC Corporation's actions taken on different occasions in the past after the consultation process.

(*Post meeting note:* An information paper on "How public views collected in relation to fares are taken into account by the MTR Corporation" was circulated to members vide LC Paper No.CB(1)591/99-00.)

11. Since RPI-X generated significant benefits for the inefficient public services in their early days in the UK private sector, Mr CHENG Kar-foo asked if there were alternatives other than the regulatory formula. Mr LINNETT advised that an alternative was to let business operators establish the right fare having regard to circumstances prevailing, and reinforce its decision with a consultation process and natural business instinct under a sensible fare policy. Since MTRC had already demonstrated itself as an efficient and quality railway, changing the existing mechanism might not be necessary. Intervention from independent regulators such as LegCo or TAC would only deviate the business decision on fare setting from the basic business principles. He stressed that the imposition of a rigid regime on business would ultimately increase the costs since investors would be hesitant to participate in the development.

12. Mr CHENG Kar-foo sought Mr LINNETT's view on adoption of the CPI-X formula in Hong Kong for the first five years after privatization. Mr LINNETT said that privatized businesses in UK were able to reduce their costs by 30% by the formula in five years, and this in fact was in relation to the level of inefficiency inherited when

the businesses were privatized. However, while the focus of the formula should be on the reduction of cost, he did not consider that MTRC could reduce its cost by the same level as that in UK given its efficiency and high quality of service.

Monopoly

13. Referring to item two under paragraph 15 of the information paper, Mr Edward HO sought clarification on the monopoly situation in UK and how this would apply to MTRC's position as the latter contributed only 25% to the share of different modes of transport in Hong Kong. Mr LINNETT explained that in UK, the RPI-X regulation was applied in essential areas where there were no alternatives. He quoted electricity supply as an example. While electricity could be purchased from any producer, the connection of electricity to individual households was operated by a sole agent which was regarded as absolute monopoly. In MTRC's case, there was no absolute monopoly as there were many alternatives modes of transport in Hong Kong.

Reasons for privatization and business risk

14. Mr CHENG Kar-foo made reference to the concluding remarks of the information paper that one reason to privatize the UK railway was to improve efficiency; he sought Mr LINNETT's view on the need for privatizing MTRC given that it was already operating efficiently. Mr LINNETT said that privatization would allow a business to operate fully in the commercial environment, provide an opportunity for MTRC to raise international capital, increase flexibility of resources and offer shares to the railway users. Priviatization of MTRC could also give Hong Kong an opportunity to demonstrate its success on an international scale. He added, however, that the decision to privatize MTRC was within the Government's prerogative.

15. Mr CHENG Kar-foo sought elaboration on the last item in paragraph 6 where it was stated that the existing form of regulation in UK left a substantial level of business risk with either the consumer or the Government. Mr LINNETT explained that the UK legislation provided a contract between the Government or the consumers and the regulated business with the regulator overseeing the contract. Since most of these businesses were essential monopolies and consumers did not have alternatives if the businesses were not well operated, regulators would have difficulties in regulating their services. While the contract aimed at ensuring operational efficiency of the business, the regulator had a legal obligation to finance the business operations when necessary. In this way, the business risk of operation rested with the Government or the consumers when fares were regulated; fare levels might therefore reflect the performance of the operations to some extent. The elements of business risk were also transferred to investors.

Structure of shareholding

16. Considering that the UK public service businesses were all majority sold

while MTRC would be minority sold after privatization, Mr Howard YOUNG enquired about the difference and impact of the two scenarios. Mr LINNETT pointed out that the situation in UK might not serve as a direct reference to Hong Kong. The businesses in UK were rigidly managed by the Government before they were released in majority into the private sector. However, as MTRC was wholly Government-owned and operated more independently than the UK organizations before privatization, it would be appropriate for the local Government to retain a majority shareholding for a period after it was privatized. Nevertheless, majority sale was not a fundamental issue in privatization.

Mid-term review

17. Mr Ambrose CHEUNG said that as the proposed regulatory framework for fare adjustment was built on the foundation of competition and consultation, he was worried that subsequent changes to the shareholding structure of the Corporation after listing might hamper the effectiveness of the said regulatory framework, bearing in mind the interests of general investors might not tally with that of the general public. Mr CHEUNG therefore enquired about the feasibility of conducting a mid-term review to introduce the CPI-X formula, if necessary, to protect public interest and whether similar mechanism had been implemented in overseas countries.

18. Mr LINNETT had not come across a similar structure as proposed by the member in his privatization experience. He doubted whether it would be advisable to conduct a review process at an intermediate stage, say 10 years after privatization, when the operation did not go well. As privatization of MTRC would draw international focus to the Corporation, he considered that such a review would only create business uncertainty. Afterall, when there were operational problems, LegCo and the Government would apply strong sanction and assume responsibility for organizations which provided essential public service. On this basis, he suggested that the Government conduct the review as and when necessary rather than doing it at a given time.

19. Mr Ambrose CHEUNG asked whether it would have significant or fatal commercial impact on privatization if the option and timing of the review were in the hands of the Government. Mr LINNETT replied that it would depend on the nature, the certainty, the terms, criteria and content of the review. He cautioned that the review might disturb investors and the business process significantly and substantially, or even fundamentally.

II Any Other Business

20. The Chairman informed members that two more experts would be invited to the next meeting on 16 December 1999.

21. There being no other business, the meeting adjourned at 12:10 pm.

Legislative Council Secretariat
5 April 2000