

# Corporate governance and other information

## Corporate Governance Practices

The Company is committed to ensuring high standards of corporate governance in the interests of shareholders and devotes considerable effort to identifying and formalising best practices.

The Company has complied throughout the half-year ended 30 June 2007 with the Code Provisions set out in the Code on Corporate Governance Practices contained in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") except that, with respect to Code Provision A.4.1, non-executive Directors of the Company are not appointed for a specific term but are subject (save for those appointed pursuant to Section 8 of the Mass Transit Railway Ordinance (Cap. 556 of the Laws of Hong Kong) (the "MTR Ordinance")) to retirement by rotation and re-election at the Company's annual general meetings in accordance with Articles 87 and 88 of the Company's Articles of Association. As there are currently nine Directors subject to the requirement to retire by rotation, and one-third of them shall retire at each annual general meeting of the Company (subject to re-election by the shareholders), each of these Directors is effectively appointed for a term of approximately three years.

Dr. Raymond Ch'ien Kuo-fung, a Member of the Board, was first appointed as the non-executive Chairman of the Company with effect from 21 July 2003 for a term of three years, which was renewed in 2006 for a further term up to 31 July 2007. In July 2007, Dr. Ch'ien was re-appointed as the non-executive Chairman of the Company with effect from 1 August 2007 for a term up to 31 December 2007 or the day to be appointed by the Secretary for Transport and Housing by notice published in the Gazette under the Rail Merger Ordinance, whichever is the earlier. The Rail Merger Ordinance relates to the proposed rail merger between the Company and KCRC, which is to take effect from the day designated pursuant to that Ordinance as the day on which the rail merger will be effective.

Mr. Chow Chung-kong was first appointed as the Chief Executive Officer of the Company with effect from 1 December 2003 for a term of three years which has been renewed for a further term of three years with effect from 1 December 2006. He is a Member of the Board.

A person may be appointed as a Member of the Board at any time either by the shareholders in general meeting or by the Board upon recommendation of the Nominations Committee of the Company. Directors who are appointed by the Board must retire at the first annual general meeting after their appointment. A Director who retires in this way is eligible for election at that annual general meeting, but is not taken into account when deciding which and how many Directors should retire by rotation. In either case, the Directors so elected and appointed are eligible for re-election and re-appointment. At each annual general meeting of the Company, one third of the Directors (or, if the number of Directors is not divisible by three, such number as is nearest to and less than one third) must retire as Directors by rotation.

The Chief Executive of the Hong Kong Special Administrative Region of the People's Republic of China ("HKSAR") may, pursuant to Section 8 of the MTR Ordinance, appoint up to three persons as "additional Directors". Directors appointed in this way may not be removed from office except by the Chief Executive of the HKSAR. These Directors are not subject to any requirement to retire by rotation nor will they be counted in the calculation of the number of Directors who must retire by rotation. In all other respects, the "additional Directors" are treated for all purposes in the same way as other Directors.

In the light of the reorganisation in the Government of the HKSAR (the "Reorganisation"), the Chief Executive of the HKSAR appointed the office of the Secretary for Transport and Housing ("S for T&H") as a non-executive Director of the Company in place of the office of the Secretary for the Environment, Transport and Works (held by Dr. Sarah Liao Sau-tung until 30 June 2007) with effect from 1 July 2007. Ms. Eva Cheng took up the post of the S for T&H starting from 1 July 2007.

As regards Alternate Directors to the office of the S for T&H, the office of the Permanent Secretary for Transport and Housing (Transport) ("PS for T&H") was appointed as an Alternate Director to the office of the S for T&H in place of the office of the Permanent Secretary for the Environment, Transport and Works (Transport) ("PS for ET&W") with effect from 1 July 2007. Mr. Joshua Law Chi-kong who held the post of the PS for ET&W up to 30 June 2007, took up the post of the PS for T&H from 1 July 2007 until Mr. Ho Suen-wai succeeded him. By virtue of his appointment as the PS for T&H, Mr. Ho became an Alternate Director to the office of the S for T&H with effect from 15 August 2007.

Besides the office of the PS for T&H, the office of the Deputy Secretary for Transport and Housing (Transport) (“DS for T&H”) was also appointed as an Alternate Director to the office of the S for T&H in place of the office of the Deputy Secretary for the Environment, Transport and Works (Transport) (“DS for ET&W”) with effect from 1 July 2007. Mr. Patrick Ho Chung-kei, Ms. Chu Man-ling, Mr. Yung Wai-hung and Ms. Lee Lai-yee who held the posts of the DS for ET&W until 30 June 2007, took up the posts for the DS for T&H starting from 1 July 2007.

Following the Reorganisation, Professor Chan Ka-keung, Ceajer, who took over the post of the Secretary for Financial Services and the Treasury from Mr. Ma Si-hang, Frederick with effect from 1 July 2007, was appointed as a non-executive Director of the Company to succeed Mr. Ma with effect from 10 July 2007. Mr. Alan Lai Nin (Permanent Secretary for Financial Services and the Treasury (Treasury)) and Mr. Leung Cheuk-man (Deputy Secretary for Financial Services and the Treasury (Treasury)2) ceased to be Alternate Directors to Mr. Ma and were appointed as Alternate Directors to Professor Chan, both effective from 10 July 2007.

### **Model Code for Securities Transactions by Directors of Listed Issuers (the “Model Code”)**

The Company has adopted the Model Code and, having made specific enquiry, confirms that Members of the Board and the Executive Directorate complied throughout the half-year ended 30 June 2007 with the Model Code set out in Appendix 10 to the Listing Rules. Senior managers who, because of their office in the Company, are likely to be in possession of unpublished price sensitive information, have been requested to comply with the provisions of the Model Code.

### **Audit Committee**

The Audit Committee meets four times each year with the purpose of monitoring the integrity of the Group’s financial statements and to consider the nature and scope of internal and external audit reviews. It also assesses the effectiveness of the systems of internal control. All the Members of the Audit

Committee are non-executive Directors, namely T. Brian Stevenson (chairman), Professor Cheung Yau-kai and the Commissioner for Transport (Alan Wong Chi-kong). Mr. Stevenson and Professor Cheung are also independent non-executive Directors.

### **Remuneration Committee**

The Remuneration Committee meets regularly to consider remuneration issues and its principal responsibilities include formulating a remuneration policy and practices that facilitate the employment of top quality personnel, recommending to the Board the remuneration of the Members of the Board who are non-executive Directors, determining the remuneration packages of the Members of the Board who are executive Directors and the Members of the Executive Directorate, and reviewing and approving performance-based remuneration by reference to the Company’s goals and objectives. All the Members of the Remuneration Committee are non-executive Directors, namely Edward Ho Sing-tin (chairman), T. Brian Stevenson and Professor Chan Ka-keung, Ceajer. Professor Chan who took over the post of the Secretary for Financial Services and the Treasury from Mr. Ma Si-hang, Frederick with effect from 1 July 2007, was appointed as a non-executive Director of the Company and a Member of the Remuneration Committee in place of Mr. Ma with effect from 10 July 2007. Mr. Ho and Mr. Stevenson are also independent non-executive Directors.

### **Nominations Committee**

The Nominations Committee carries out the process of nominating and recommending candidates to fill vacancies on the Board of Directors. All the Members of the Nominations Committee are non-executive Directors, namely David Gordon Eldon (chairman), Lo Chung-hing and the S for T&H (Eva Cheng). The S for T&H, who was appointed by the Chief Executive of the HKSAR as a non-executive Director of the Company in place of the S for ET&W with effect from 1 July 2007, was appointed as a Member of the Nominations Committee with effect from 1 July 2007. Mr. Eldon and Mr. Lo are also independent non-executive Directors.

### Independent Committee

In respect of the proposed rail merger between the Company and Kowloon-Canton Railway Corporation ("KCRC"), and for the purpose of looking after the interest of independent minority shareholders and ensuring good corporate governance, the Board has established the Independent Committee of the Board ("IBC").

The principal responsibilities of the IBC include advising the Company's independent minority shareholders as to whether the terms of the proposed rail merger between the Company and KCRC are fair and reasonable, whether the proposed rail merger is in the interests of the Company and its shareholders as a whole, and on how to vote, after taking into account the recommendations of the independent financial adviser required to be appointed by the Company under the Listing Rules.

All the Members of the IBC are independent non-executive Directors, namely Edward Ho Sing-tin (chairman), Professor Cheung Yau-kai, David Gordon Eldon, Christine Fang Meng-sang, Lo Chung-hing and T. Brian Stevenson.

### Internal Controls

The Board is responsible for the system of internal controls of the Company and its subsidiaries, setting appropriate policies and reviewing the effectiveness of such controls.

Pursuant to the Protocol adopted by the Board, the Board has delegated the day-to-day management of the Company's business to the Executive Committee, and focuses its attention on matters affecting the Company's overall strategic policies, finances and shareholders.

The Executive Committee is responsible for implementing the Board's policies on risk and control. In fulfilling its responsibilities, the Executive Committee identifies and evaluates the risks faced by the Company for consideration by the Board and designs, operates and monitors a suitable system of internal controls which implements the policies adopted by the Board. The Executive Committee is accountable to the Board for monitoring the system of internal controls and providing assurance to the Board that it has done so. Additionally, all employees have responsibility for internal controls within their areas of accountability.

The Board, as advised by the Executive Committee, has established various risk management strategies and insurance coverage arrangements to identify, assess and reduce risks. The Company introduced in early 2006 an Enterprise Risk Management ("ERM") framework for the strategic management of business risks. The framework covers the major business areas of the Company and facilitates the effective communication of risk knowledge at different levels of the organization.

The Enterprise Risk Committee, delegated by the Executive Committee, oversees the operation of the ERM framework, the effectiveness of which is underpinned by line management taking direct risk management responsibilities as risk owners. The framework is subject to continuous improvement through periodic audits and evaluation. The Audit Committee and the Board periodically review the implementation and the ERM organization and processes that have been put in place.

The Internal Audit Department plays a major role, independent of the Company's management, in assessing and monitoring the internal controls of the Company. The Internal Auditor reports to the Chief Executive Officer and has direct access to the Audit Committee. The Department has unrestricted access to information that allows it to review all aspects of the Company's risk management, control and governance processes.

On behalf of the Board, the Audit Committee evaluates annually the effectiveness of the Company's system of internal controls, including the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

A review of the effectiveness of the Company's system of internal control for the year ended 31 December 2006, covering all material financial, operational and compliance controls, and risk management function has been conducted. The Board has reported in the 2006 Annual Report that adequate and effective internal controls were maintained to safeguard the shareholders' investment and the Company's assets and there were no significant control failings, weaknesses or significant areas of concern identified during the year 2006 which might affect shareholders.

## Board Members' and Executive Directorate's Interests in Shares

As at 30 June 2007, the interests or short positions of the Members of the Board and the Executive Directorate in the shares, underlying shares and debentures of the Company (within the meaning of Part XV of the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong) ("SFO")) as recorded in the register required to be kept under section 352 of the SFO or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited ("HKSE") pursuant to the Model Code were as follows:

### Long Positions in Shares and Underlying Shares of the Company

Member of the Board or the Executive Directorate	Number of Ordinary Shares held			Derivatives		Total interests	Percentage of aggregate interests to total issued share capital
	Personal* interests	Family <sup>†</sup> interests	Corporate interests	Share Options	Other		
Chow Chung-kong	–	–	–	–	418,017 (Note 1)	418,017	0.00748
T. Brian Stevenson	4,755	–	–	–	–	4,755	0.00009
Christine Fang Meng-sang	1,712	–	–	–	–	1,712	0.00003
Russell John Black	54,748	–	–	–	–	54,748	0.00098
William Chan Fu-keung	46,960	–	–	217,500 (Note 2)	–	264,460	0.00473
Thomas Ho Hang-kwong	54,640	2,541	–	321,000 (Note 2)	–	378,181	0.00677
Lincoln Leong Kwok-kuen	23,000	–	23,000 (Note 3)	1,043,000 (Note 4)	160,000 (Note 5)	1,249,000	0.02235
Francois Lung Ka-kui	46,000	2,500	–	1,066,000 (Note 4)	–	1,114,500	0.01994

Notes:

- Chow Chung-kong has a derivative interest in respect of 418,017 shares in the Company within the meaning of Part XV of the SFO. That derivative interest represents Mr. Chow's entitlement to receive an equivalent value in cash of 418,017 shares in the Company on completion of his three-year contract (on 30 November 2009).
- Further details of the above share options are set out in the table below showing details of the options to subscribe for ordinary shares granted under the Pre-Global Offering Share Option Scheme.
- The 23,000 shares are held by Linsan Investment Ltd., a private limited company beneficially wholly owned by Lincoln Leong Kwok-kuen.
- Further details of the above share options are set out in the table below showing details of the options to subscribe for ordinary shares granted under the New Joiners Share Option Scheme.
- Lincoln Leong Kwok-kuen has a derivative interest in respect of 160,000 shares in the Company within the meaning of Part XV of the SFO. That derivative interest represents Mr. Leong's entitlement to receive an equivalent value in cash of 160,000 shares in the Company on 9 April 2010.

\* Interests as beneficial owner

<sup>†</sup> Interests of spouse or child under 18 as beneficial owner

### Options to subscribe for Ordinary Shares granted under the Pre-Global Offering Share Option Scheme

Executive Directorate and eligible employees	Date granted	No. of options granted	Period during which rights exercisable (day/month/year)	Options outstanding as at 1 January 2007	Options vested during the period	Options lapsed during the period	Options exercised during the period	Exercise price per share of options (HK\$)	Options outstanding as at 30 June 2007	Weighted average closing price of shares immediately before the date(s) on which options were exercised (HK\$)
										–
William Chan Fu-keung	20/9/2000	1,066,000	5/4/2001 – 11/9/2010	217,500	–	–	–	8.44	217,500	–
Thomas Ho Hang-kwong	20/9/2000	1,066,000	5/4/2001 – 11/9/2010	321,000	–	–	–	8.44	321,000	–
Other eligible employees	20/9/2000	41,409,000	5/4/2001 – 11/9/2010	7,291,000	–	–	711,000	8.44	6,580,000	20.24

Note:

All of the above share options were vested on 5 October 2003. The proportion of underlying shares in respect of which the share options have vested is as follows:

Date	Proportion of underlying shares in respect of which an option is vested
Before 5 October 2001	none
5 October 2001 to 4 October 2002	one-third
5 October 2002 to 4 October 2003	two-thirds
After 4 October 2003	all

## Options to subscribe for Ordinary Shares granted under the New Joiners Share Option Scheme

Executive Directorate and eligible employees	Date granted	No. of options granted	Period during which rights exercisable (day/month/year)	Options	Options granted during the period	Options vested during the period	Options lapsed during the period	Options exercised during the period	Exercise price per share of options (HK\$)	Options outstanding as at 30 June 2007	Weighted average closing price of shares immediately before the date(s) on which options were exercised (HK\$)
				outstanding as at 1 January 2007							
Lincoln Leong Kwok-kuen	1/8/2003	1,066,000	14/7/2004 – 14/7/2013	1,043,000	–	–	–	–	9.75	1,043,000	–
Francois Lung Ka-kui	22/3/2007	1,066,000	19/3/2008 – 19/3/2017	–	1,066,000	–	–	–	19.404	1,066,000	–
Other eligible employees	1/8/2003	495,200	14/7/2004 – 14/7/2013	268,200	–	–	–	31,000	9.75	237,200	19.60
	12/1/2006	94,000	9/1/2007 – 9/1/2016	94,000	–	31,500	–	–	15.45	94,000	–
	13/9/2005	94,000	9/9/2006 – 9/9/2015	94,000	–	–	–	–	15.97	94,000	–
	23/9/2005	213,000	9/9/2006 – 9/9/2015	213,000	–	–	–	–	15.97	213,000	–
	31/3/2006	94,000	20/3/2007 – 20/3/2016	94,000	–	31,500	–	–	18.05	94,000	–
	4/7/2006	94,000	19/6/2007 – 19/6/2016	94,000	–	31,500	–	–	18.30	94,000	–
	17/11/2006	94,000	13/11/2007 – 13/11/2016	94,000	–	–	–	–	19.104	94,000	–
	5/10/2006	94,000	29/9/2007 – 29/9/2016	94,000	–	–	–	–	19.732	94,000	–
	12/5/2006	266,500	25/4/2007 – 25/4/2016	266,500	–	89,000	–	–	20.66	266,500	–
	15/5/2006	213,000	25/4/2007 – 25/4/2016	213,000	–	71,000	–	–	20.66	213,000	–
12/5/2006	213,000	2/5/2007 – 2/5/2016	213,000	–	71,000	–	–	21.00	213,000	–	

## Notes:

- The exercise price of the share options is determined upon the offer of grant of the options and which should not be less than the greatest of (a) the average closing price per share of the Company for the five business days immediately preceding the date of offer of such options; (b) the closing price per share of the Company on the date of offer of such options, which must be a business day; and (c) the nominal value per share of the Company.
- The proportion of underlying shares in respect of which the above share options will vest is as follows:

Date	Proportion of underlying shares in respect of which an option is vested
Before the first anniversary of the date of offer of the option (the "Offer Anniversary")	none
From the first Offer Anniversary to the date immediately before the second Offer Anniversary	one-third
From the second Offer Anniversary to the date immediately before the third Offer Anniversary	two-thirds
From the third Offer Anniversary and thereafter	all

During the six months ended 30 June 2007, 1,066,000 options to subscribe for shares of the Company were granted to Francois Lung Ka-kui, a member of the Executive Directorate, under the New Joiners Share Option Scheme. Pursuant to the terms of this Scheme, he undertakes to pay HK\$1.00, on demand, to the Company, in consideration for the grant of the options (the closing market price per share immediately before the date on which the options were granted was HK\$19.32). The share options granted are recognised on an accrued vesting basis in the accounts. The weighted average value per option granted, estimated at the date of grant using the Black-Scholes pricing model is as follows:

Date granted	Estimated risk-free interest rate (%)	Expected life (Years)	Estimated Volatility	Expected dividend per share (HK\$)	Weighted average value per option granted (HK\$)
22/3/2007	3.96	5	0.21	0.42	3.79

The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options and requires input of highly subjective assumptions, including the expected life and stock price volatility. Since the Company's share options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimates, the Black-Scholes option pricing model does not necessarily provide a reliable measure of the fair value of the share options.

Save as disclosed above:

**A** none of the Members of the Board or the Executive Directorate of the Company had any interest or short position in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO); and

**B** during the six months ended 30 June 2007, no Member of the Board or the Executive Directorate nor any of their spouses or children under 18 years of age held any rights to subscribe for equity or debt securities of the Company nor had there been any exercises of any such rights by any of them,

as recorded in the register kept by the Company under section 352 of the SFO or otherwise notified to the Company and the HKSE pursuant to the Model Code.

### Substantial Shareholders' Interests

Set out below is the name of the party which was interested in 5% or more of the nominal value of the share capital of the Company and the number of shares in which it was interested as at 30 June 2007 as recorded in the register kept by the Company under section 336 of the SFO:

Name	No. of Ordinary Shares	Percentage of Ordinary Shares to total issued share capital
The Financial Secretary Incorporated (in trust on behalf of the Government)	4,285,040,314	76.68

The Company has been informed by the Government that, as at 30 June 2007, approximately 0.97% of the shares of the Company were held for the account of the Exchange Fund. The Exchange Fund is a fund established under the Exchange Fund Ordinance (Cap. 66 of the Laws of Hong Kong) under the control of the Financial Secretary.

### Loan Agreements with Covenant Relating to Specific Performance of the Controlling Shareholder

As at 30 June 2007, the Group had facilities of HK\$43,557 million in aggregate with maturities ranging from 2007 to 2020, which were subject to a condition that the Government, being the Company's controlling shareholder, owns more than half in nominal value of the voting share capital of the Company during the terms of these facilities. Otherwise, the outstanding borrowings may be subject to immediate repayment upon demand or the undrawn facilities may be cancelled as a result.

### Purchase, Sale or Redemption of Own Securities

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any of its listed securities during the six months ended 30 June 2007.

### Closure of Register of Members

The Register of Members of the Company will be closed from 31 August 2007 to 6 September 2007 (both dates inclusive), during which period no transfer of shares can be registered. In order to qualify for the interim dividend, all transfers, accompanied by the relevant share certificates, must be lodged with the Company's Registrar, Computershare Hong Kong Investor Services Limited at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, for registration no later than 4:30 p.m. on 30 August 2007. The 2007 interim dividend is expected to be paid on or about 26 October 2007 to shareholders whose names appear on the Register of Members of the Company on 6 September 2007.