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MTR CORPORATION LIMITED

香港鐵路有限公司

(the 'Company')

(Incorporated in Hong Kong with limited liability)

(Stock Code: 66)

Inside Information

First Report by the Independent Board Committee regarding the Hong Kong Section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link Project

Mr. Jay Herbert Walder to step down as CEO

Resumption of trading

This announcement is made pursuant to Rule 13.09(2) of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and Part XIVA of the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong).

The IBC

The Company announces that the Committee of Independent Non-executive Directors (the "**IBC**") established by the Board in April 2014 has issued its first report regarding the XRL (the "**First Independent Committee Report**"). The IBC will prepare a second report on the manner in which the Company can deliver the Project in a transparent and timely manner and in accordance with the Company's obligations under the Entrustment Agreement going forward. The IBC has also appointed two independent experts who have specific expertise in relation to management of projects of this type to assist it with its review. It is currently expected that this second report will be issued in October 2014.

A meeting of the Board was held today to consider the First Independent Committee Report and the Board has adopted in full the IBC's recommendations in the First Independent Committee Report. A summary of such recommendations is set out below.

In addition, a summary of the IBC's findings in the First Independent Committee Report is set out in Appendix 1 to this announcement.

A copy of the First Independent Committee Report will be available on the

Company's website (www.mtr.com.hk).

Recommendations of the IBC

As a result of the IBC's findings and conclusions, the IBC recommends that there should be certain enhancements to the Company's systems and processes:

(A) the Board should review with the ExCom the format and content of future project reporting to the Board and the Audit Committee to ensure that both are presented with clear and comprehensive information regarding the projects underway as well as being advised of the critical challenges facing each project. There should also be a review of financial progress of each project. The reporting on individual projects as above should then be summarised for the Board and the Audit Committee by the PjD, signed off by project programming and procurement teams and endorsed by the CEO and the FD;

(B) the Board should establish a Capital Works Committee to oversee in the future any project involving design and/or construction with a capital value of a certain material size as assessed by the Board. Each relevant project should be the subject of quarterly review by the Capital Works Committee. The Capital Works Committee would consist of such members as the Board determines and be chaired by an INED. The principal intention of the Capital Works Committee is to report to the Board on the progress of the relevant projects and their respective budgets;

(C) the ExCom should review its system of allocating clear accountability for actions required and for subsequent follow-up that those actions have been taken;

(D) the Board and the ExCom should encourage a culture of healthy debate and constructive challenge by all team members within the Company;

(E) recognising that corporate communications are a strategic matter for the Company, the IBC urges the Board to undertake a comprehensive review of the Company's communications strategy with the aim to improve transparency, timeliness and pro-active engagement with stakeholders, particularly the public; and

(F) the IBC recommends a review of the corporate relations planning in respect of progress of projects, including a review of the flow of information among the PjT, ExCom and Corporate Relations Department as well as how the Projects Division identifies and anticipates issues for communication.

Mr. Jay Herbert Walder to step down as CEO

The Company had previously confirmed that Mr. Jay Herbert Walder, the CEO, would not be renewing his service contract when it expires at the end of August next year. During discussion of the First Independent Committee Report today, the Board and Mr. Walder mutually agreed that given Mr. Walder would only

have been CEO for one more year, it would be beneficial for the Company to be taken forward under a new leadership who can provide commitment to the Company beyond 2015. As such, Mr. Walder will step down as CEO from 15 August 2014. His position as a member of the Board will also end on that date.

There are no disagreements between the Board and Mr. Walder and there are no other matters relating to Mr. Walder stepping down from his position as CEO and a member of the Board that need to be brought to the attention of holders of securities of the Company.

The Company is undertaking a worldwide search to identify the right candidate for the post of the CEO.

Mr. Lincoln Leong Kwok-kuen, the current Deputy CEO, will assume the role of acting CEO to manage the duties and responsibilities of the CEO starting from 16 August 2014 until a new CEO is appointed by the Company.

Resumption of trading

At the request of the Company, trading in the shares (stock code: 66) and the debt securities (stock code: 4541, 5958 & 6025) (together, the “**Listed Securities**”) of the Company was halted from 11:00 a.m. on 16 July 2014 pending the release of this announcement. An application has been made by the Company for the resumption of trading in the Listed Securities on The Stock Exchange of Hong Kong Limited with effect from 9:00 a.m. on 17 July 2014.

Definitions

In this announcement, the following expressions have the meanings set out below:

“**Audit Committee**” means the Audit Committee of the Board of the Company;

“**Board**” means the board of directors of the Company;

“**CEO**” means the Chief Executive Officer of the Company;

“**Chairman**” means the Chairman of the Board;

“**Corporate Relations Department**” means the Corporate Relations Department of the Company;

“**Day-1**” means the full train services requirements and patronage forecast agreed with Government;

“**Deputy CEO**” means the Deputy Chief Executive Officer of the Company;

“**DRM(s)**” means delay recovery measure(s);

“**Entrustment Agreement**” means the Entrustment Agreement between the Company and Government dated 26 January 2010;

“**ExCom**” means the Executive Committee of the Company;

“**FD**” means the Finance Director of the Company;

“**Government**” means Government of the Hong Kong Special Administrative Region;

“**INED**” means an independent non-executive director of the Company;

“**M&V Consultant**” means the monitoring and verification consultant;

“**MOR**” means Minimum Operating Requirement. MOR was the term used on occasion by members of the PjT to describe a partial opening scenario for WKT to achieve opening in 2015;

“**Partial Opening**” means the partial opening of WKT on a MOR basis;

“**PjD**” means the Projects Director of the Company;

“**PjT**” means the Company’s project team for the XRL. The PjT is within the Projects Division of the Company;

“**Project**” means the XRL project;

“**STH**” means the Secretary for Transport and Housing;

“**TBM(s)**” means tunnel boring machine(s) used in the construction of the XRL;

“**WKT**” means the West Kowloon Terminus; and

“**XRL**” means the Hong Kong section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link.

By Order of the Board
Gillian Elizabeth Meller
Company Secretary

Hong Kong, 16 July 2014

As at the date of this announcement:

Members of the Board: Dr. Raymond Ch'ien Kuo-fung (*Chairman*)**, Jay Herbert

Walder (*Chief Executive Officer*), Pamela Chan Wong Shui*, Dr. Dorothy Chan Yuen Tak-fai*, Vincent Cheng Hoi-chuen*, Christine Fang Meng-sang*, Edward Ho Sing-tin*, Professor Frederick Ma Si-hang*, Alasdair George Morrison*, Ng Leung-sing*, Abraham Shek Lai-him*, T. Brian Stevenson*, Professor Chan Ka-keung, Ceajer (Secretary for Financial Services and the Treasury)**, Secretary for Transport and Housing (Professor Anthony Cheung Bing-leung)** and Commissioner for Transport (Ingrid Yeung Ho Poi-yan)**

Members of the Executive Directorate: Jay Herbert Walder, Lincoln Leong Kwok-kuen, Morris Cheung Siu-wa, Chew Tai Chong, Jacob Kam Chak-pui, Stephen Law Cheuk-kin, Gillian Elizabeth Meller, David Tang Chi-fai and Jeny Yeung Mei-chun

* *independent non-executive Director*

** *non-executive Director*

This announcement is made in English and Chinese. In case of any inconsistency, the English version shall prevail.

Appendix 1

Findings of the IBC

Set out below is a summary of the IBC's findings in the First Independent Committee Report.

Reasons for delay

The reasons for delay to the Project are numerous. Some apply to the Project as a whole, including labour shortage issues which are affecting all construction projects in Hong Kong, other reasons vary by contract area and may relate, for example, to local geology, different site access issues in the early phases of the Project or unforeseen events occurring. More specifically, for contract 810A (WKT), progress had been and is still affected by unfavourable ground conditions, utility diversion complications, site co-ordination and inadequate work fronts. For contract 826 (cross-boundary tunnelling), progress had been affected by the late arrival of the TBMs from the Mainland. For contract 823A (Yuen Long Tunnel section), progress had been affected by the slow excavation rate of the two TBMs. The flooding of one of the TBMs has made things worse. However, the IBC has not seen any evidence to suggest that in its day-to-day work the PjT has not followed the systems and procedures established in accordance with the requirements of the Entrustment Agreement and vetted by Government and the independent M&V Consultant appointed by Government.

Partial Opening Proposal

Due to the delays at WKT, a plan was proposed by the PjT in mid 2013 to enable a passenger service that would still be able to meet all of the operational requirements that had been agreed with Government. However, it would also allow certain other non-essential works (i.e. non-essential to Day-1 operations) at WKT to be completed during the following six months or so. There were two key changes introduced under the Partial Opening proposal. First, the service would be initiated with just six long-haul tracks rather than a total of 10 short-haul and long-haul tracks. Second, there would still be ongoing construction works after the start of passenger operations, including parts of the facility and non-essential works such as footbridges. The permanent roof of the terminus would also be completed after the railway had become operational.

The Partial Opening proposal was not a unilateral solution that could be imposed on Government under the terms of the Entrustment Agreement. If implemented, this would have been a material change to the Project programme which would have required the agreement of Government. The Partial Opening proposal was not reported on to the Board although it was presented to Government.

It is the IBC's view that the distinction between operational matters, which are within the authority of the ExCom, and strategic matters of public importance, which should be escalated to the Board, was not given sufficient attention by the ExCom after it had been made aware of the Partial Opening proposal. The IBC

finds that the failure to report the Partial Opening proposal by the ExCom to the Board reflects poor judgement in particular on the part of the PjD (when taking into account his role and responsibilities as overall projects director of the Company) and the CEO (when taking into account his role and responsibilities as chief executive officer of the Company).

Entrustment Agreement

All contracts for the Project are subject to variations in time and cost due to unforeseen circumstances and changes that may be required. In a vastly complex engineering project such as the XRL, unforeseen events will happen. The Company agreed under the terms of the Entrustment Agreement to use its best endeavours to complete the Project by the original estimated completion date in August 2015.

Since the commencement of the Project, the Company has implemented processes and procedures to ensure that it is carrying out its obligations under the Entrustment Agreement. Government has been constantly monitoring the Project within the framework provided in the Entrustment Agreement.

The Company's Project Management

The IBC believes that the PjT has managed the engineering aspects of the delays in the Project arising from a number and wide variety of circumstances and events in a professional manner.

Notwithstanding this conclusion, the IBC has appointed two independent experts to review the Company's project management systems and processes in respect of the Project. They will then be asked to propose any enhancements they may see as appropriate.

Reporting to Government

The IBC believes that through the life of the Project, members of the PjT and Government representatives have worked together in a co-operative and collaborative manner. Delays against the Project programme have been reported on a timely basis and accurately to Government in accordance with the terms of the Entrustment Agreement. The IBC does not find any attempt by the PjT or the Company to cover-up or hide the delays being experienced in the various Project contracts. However, Government was often assured by the Company that delays in the Project could be recovered to achieve opening in 2015.

The PjD did not communicate with Government the mounting concerns of the PjT expressed in November 2013 as to the cumulative effect of delays across key parts of the Project and that, as a result, the completion date would fall in 2016. The IBC believes that while Government clearly had access to a great deal of information about the delays on the various contracts, it should have been given a fuller assessment of the achievability of the overall Project timetable.

Reporting on the Project to the CEO, ExCom, Audit Committee, Board and Chairman

Within the Company there are a number of matters delegated by the Board to be dealt with by the ExCom without needing to be referred back to the Board for approval.

However, the IBC finds that important matters relating to the Project were not brought to the attention of the Chairman, Audit Committee or Board. The result was that the Board could not monitor effectively the progress of the Project and provide guidance and, where necessary, challenge the views and actions of the CEO, PjD and other members of the Executive Directorate in relation to the Project.

Indeed, when the PjD was questioned by INEDs at its meetings on 22 August and 10 December 2013 about the progress of the Project, he had consistently responded that the Project would be delivered on time and within budget. He never suggested that the cumulative effect of various contract delays, including on contracts 810A and 826, was making the anticipated timetable irretrievable (whether or not on a Partial Opening basis). He also did not report fully and accurately to the CEO, ExCom, Audit Committee or Board information presented by the PjT indicating their concerns about the delivery of the Project.

The CEO has indicated to the IBC that, in addition to attending a number of ExCom meetings at which certain members of the PjT were present with the PjD, he also met with the PjD individually and reviewed with him the status of the Project on a frequent basis. In those meetings the CEO had accepted and relied in good faith upon the assurances given to him by the PjD that notwithstanding the delays the Project would still complete by the end of 2015 on a Partial Opening basis.

The IBC believes that the PjD should have responded directly and openly to the questions and concerns raised by members of the Board as to whether the Project was on time to complete by 2015 and on budget.

When asked by the IBC as to why he did not report the concerns of the PjT, the PjD stated that, pending a response from the contractor at WKT to the Partial Opening plan proposed by the PjT, he believed that there was still time to the end of 2015 for DRMs to be implemented and be effective. It is also unfortunate that there was a "chain of command" style of approach within the PjT as to who did the talking so that caution and concerns were not openly raised by others to challenge the PjD's assertions that an opening for the XRL in 2015 was achievable and the PjD's failure to notify the CEO, ExCom, Audit Committee and Board of such concerns of the PjT.

The PjD's assertions that the cumulative delays could be recovered were misconceived and should have been acknowledged by the PjD as such much earlier than was the case. The CEO and ExCom were collectively relying on the information and views provided by him.

Notwithstanding the above, given the CEO's knowledge of the sustained delays

in the Project programme and particularly given the importance of the Project to Government, and the level of public interest in it, the IBC believes that the CEO should have exercised more critical judgement in respect of monitoring the progress of the Project as a whole.

Communication strategy and crisis management

The CEO and other members of the ExCom (except the PjD) were not aware of the delay in the Project timetable to 2017 until it was presented to them by the PjD at the meeting on 12 April 2014. However, the PjT had been projecting the likelihood of delays beyond 2015 since November 2013 and this had not been communicated by the PjD to the CEO and ExCom.

Consequently, the ExCom at that meeting, and without any prior preparation or any communication plan, had immediately to review the Company's position in terms of communication of the delay to Government and the Hong Kong public, provide a feasible likely completion date for the Project and mitigate the resulting lack of credibility that the Company would suffer due to the inability to deliver the Project in line with the assurances given to Government. The CEO immediately informed the Chairman and the STH of the delay in the Project and began to discuss with each of them a communication strategy in relation to the delay.

Government indicated to the Chairman, CEO and PjD on 14 April 2014 that the STH would make an announcement the next day. The Company meanwhile prepared a press statement and press briefing for release on 15 April 2014. Their content was initiated and co-ordinated by the General Manager - Corporate Relations and circulated for review to the senior members of the PjT, the PjD, the CEO, certain other members of the ExCom and the Chairman for their comment and approval.

Although the CEO had contacted the Chairman immediately upon learning of the delay on 12 April, at no time prior to the issue of the press release did the Chairman or CEO raise the possibility of calling an emergency Board meeting to discuss the Project delay.

The IBC finds that:

(A) the failure of the PjD to communicate the likelihood of delays had deprived the Company of the opportunity to manage the situation in which it found itself on 12 April and the following few days in the best possible way;

(B) although the Chairman was promptly notified by the CEO of the delay and was advised on the communication strategy, an emergency Board meeting should have been called prior to the press briefing or the release of a press statement on 15 April 2014 to review a detailed communication strategy for announcing the delay and steps to be taken to achieve the earliest possible opening of the XRL for passenger services;

(C) the Company should have given a press conference on 15 April 2014 as

opposed to a press briefing;

(D) notwithstanding the CEO had been advised not to attend the Company's media briefing on 15 April 2014, in recognition of the importance given to the Project by Government and the public, particularly in the light of the statement made by the STH at the Government media stand-up earlier that day, the CEO should have led the press briefing as opposed to the PjD;

(E) by its tone and content the press statement materially overstated the effect on the Project programme of the flooding of the TBM (contract 823A);

(F) the Company's media management does not appear to have been effective in the days following the press statement and press briefing;

(G) while the genesis of the crisis on the XRL was the delay itself, poor communication management led to the delay becoming a crisis; and

(H) all of the above led to a serious loss of credibility for the Company.