

LEGISLATIVE COUNCIL PANEL ON TRANSPORT

The New Hong Kong Tunnel Company Limited's Application for Toll Increase

PURPOSE

This paper seeks Members' views on an application from the New Hong Kong Tunnel Company Limited (NHKTC) to increase the tolls of the Eastern Harbour Crossing (EHC).

BACKGROUND

2. On 7 April 1986, NHKTC was granted a 30-year franchise to build and operate the EHC. The EHC was opened to traffic on 21 September 1989.

3. Section 55(3)(a) of the EHC Ordinance (Cap. 215) provides that the tolls specified in the Schedule to the Ordinance may be varied by agreement between the Chief Executive-in-Council and the tunnel company. If an agreement cannot be reached, either side may resort to arbitration under the Arbitration Ordinance (Cap. 341). While the EHC Ordinance does not set out the criteria for determining toll adjustments, it stipulates that if the matter is submitted for arbitration, the Arbitrator shall be guided by the need to ensure that the company is **reasonably but not excessively remunerated** for its obligations under the EHC Ordinance. A copy of section 55 of the EHC Ordinance is at **Annex A**.

4. In May 1995, NHKTC submitted for the first time an application for a \$10 or 100% toll increase for private cars and similar percentage increases for other types of vehicles. The then Governor-in-Council rejected the application in October 1995. NHKTC formally notified the Government in January 1996 that it would resort to arbitration and both sides agreed on an Arbitrator in the same month. Arbitration hearing took place in February 1997.

5. A Final Interim Award was made by the Arbitrator in April 1997 which specified that the toll for private cars and taxis should be increased by \$5 (from \$10 to \$15) with corresponding increases for other types of vehicles with effect from 1 January 1998. The Arbitrator also ruled that a reasonable but not excessive remuneration to NHKTC fell within a range of 15% to 17% Internal Rate of Return (IRR). The Arbitrator believed that it was desirable to have small regular increases rather than fewer more drastic increases. Hence, he anticipated that further \$5 increases at approximately five-yearly intervals thereafter would prove necessary assuming that the projected traffic flows which were agreed by the experts then proved to be reasonably accurate.

6. While future arbitrators may make reference to the ruling in 1997, it is not binding on subsequent arbitrations.

NHKTC'S APPLICATION FOR TOLL INCREASE

7. NHKTC submitted on 27 September 2002 an application for a \$5 or 33.3% toll increase for private cars with proportionate increases for other categories of vehicles to take effect from 1 January 2003. The existing and proposed toll levels are set out at **Annex B**.

NHKTC's Justification for Toll Increase

8. A note on the toll increase application, prepared by the NHKTC, is at **Annex C**. In brief, the Company has advanced the following justifications -

- (a) according to the arbitration award made in 1997, a "reasonable return" was defined as an IRR between 15% and 17%. Even with the current proposed toll increase, the IRR likely to be achieved over the life of the franchise will be 14.76% which falls short of the lower range of a "reasonable return". Should there be no toll increases, the IRR over the whole franchise period will be 13.73% which is again less than the lower range of a reasonable IRR;

- (b) when comparing the current situation of EHC with that presented to the Arbitrator back in 1996, many assumptions have not turned out as projected, however, in calculating the likely return on equity over the life of the franchise, there is no combination of reasonable assumptions in which its return would get even close to the higher level of a reasonable return; and
- (c) postponement of the current proposed toll increase may mean a larger toll increase later to enable the Company to achieve a reasonable return. This will create an unfair situation where future tunnel users will in fact be subsidising earlier users.

NHKTC's Financial Performance

9. NHKTC has consistently enjoyed a healthy financial position with all bank loans fully repaid in July 2001. The Company's cumulative profit up to end 2002 stood at \$2,135 million. NHKTC started paying dividends from 1994 onwards and dividends have been paid on a monthly basis since October 2001. The amount of dividends paid in 2002 was \$381 million and total dividends paid up to the end of 2002 amounted to \$1,604 million.

10. Taking into account the actual dividends distributed in 2002, the IRR projections would increase slightly from 13.73%, if no toll increase is effected, and 14.76%, based on a proposed \$5 toll increase on 1 January 2003 (as submitted by NHKTC), to 13.75% and 14.78% respectively.

The Administration's Assessment

11. In considering NHKTC's franchise bid in 1986, Government agreed the opening tolls but gave no undertaking in respect of any subsequent toll increase. Neither was there any discussion nor agreement between Government and NHKTC on the level of the IRR. Each toll increase application will have to be considered on its merits.

12. From the traffic management point of view, the design capacity of the EHC is 78,500 vehicles per day and the average daily traffic throughput has been maintained at a level between 70,000 and 74,000 since the relocation of the airport. No undue congestion is observed at the tunnel's approach roads.

13. The Administration has urged NHKTC to reconsider the need and the timing for any toll increase under the current economic situation. We have also reminded them of the importance of striking a balance between the interest of the community at large and commercial considerations in devising their tolling strategy but to no avail. NHKTC maintained that the application be submitted to the Chief Executive-in-Council for consideration as soon as possible.

14. If the toll increase application is rejected, NHKTC may resort to arbitration. The arbitration ruling in 1997 will be regarded as a reference of what constitutes a "reasonable but not excessive remuneration". It is however not binding on subsequent cases and each case has to be considered on its own merit. Under the EHC Ordinance, the arbitrator is required to have regard to any material change in the economic conditions of Hong Kong since the enactment of the Ordinance or, as the case may be, since tolls were last determined.

ADVICE SOUGHT

15. Members' views are invited on NHKTC's application for toll increases at the EHC.

Environment, Transport and Works Bureau
Transport Branch
20 June 2003

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Section of Enactment

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Chapter:	215	Title:	EASTERN HARBOUR CROSSING ORDINANCE	Gazette Number:	
Section:	55	Heading:	Road Company to charge approved tolls for use of road tunnel	Version Date:	30/06/1997

PART IX

COLLECTION OF TOLLS

(1) Subject to this Ordinance, the Road Company may demand and collect tolls in respect of the passage of motor vehicles through the road tunnel.

(2) The tolls that may be collected under subsection (1) shall be those specified in the Schedule.

(3) The tolls specified in the Schedule may be varied-

- (a) by agreement between the Governor in Council and the Road Company; or
- (b) in default of agreement by submission of the question of the variation of tolls to arbitration under the Arbitration Ordinance (Cap 341) by either the Governor in Council or the Road Company.

(4) On a submission to arbitration under subsection (3), the arbitrators shall be guided by the need to ensure that the carrying out by the Road Company of its obligations, or the exercise of its rights, under this Ordinance is reasonably but not excessively remunerative to the Road Company, having regard to-

- (a) any material change in the economic conditions of Hong Kong since the enactment of this Ordinance or, as the case may be, since tolls were last determined under this section;
- (b) the dismissal of any appeal by the Road Company made under section 75;
- (c) any material change in any other circumstances affecting the exercise by the Road Company of its rights under the franchise granted by section 4(1);
- (d) the effect of the introduction of, or alteration in, any tax or levy imposed on the use of the road tunnel;
- (e) the principle that tolls or future rights to tolls should not be used to finance the construction of the railway works or to discharge directly or indirectly any obligation imposed on the Rail Company by this Ordinance; and
- (f) any other relevant matter.

(5) Where under subsection (3)-

- (a) the Governor in Council and the Road Company agree to a variation of the tolls; or
- (b) in an award pursuant to submission to arbitration it is determined that the tolls should be varied,

the tolls specified in the Schedule shall be varied in compliance with such agreement or award, as the case may be.

(6) The Commissioner shall, by notice in the Gazette, as soon as is practicable after such agreement or award as is referred to in subsection (5) amend the Schedule.

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Eastern Harbour Crossing Toll Schedule

Vehicle Type	Current Toll Level (\$)	Proposed Toll Level (\$)
Motorcycle	8	10
Private Car, Taxi	15	20
Light Bus	23	30
Light Goods Vehicle	23	30
Medium Goods Vehicle	30	40
Heavy Goods Vehicle	45	60
Single-Deck Bus	30	40
Double-Deck Bus	45	60
Additional Axle	15	20

**NEW HONG KONG TUNNEL COMPANY LIMITED
TOLL INCREASE APPLICATION
EXECUTIVE SUMMARY**

Background

- (1) The Eastern Harbour Tunnel (EHT) is a Build – Operate – Transfer infrastructure constructed and operated by the New Hong Kong Tunnel Company Limited (NHKTC) under a 30-year franchise which was granted by the Government and commenced on 7 August 1986. EHT was opened to traffic on 21 September 1989 on time and within budget.
- (2) EHT plays a vital role in keeping Hong Kong moving – 74,000 vehicles per day use it.
- (3) Under the Eastern Harbour Crossing Ordinance, the NHKTC is entitled to “a reasonable but not excessive” remuneration over the 30-year life of the franchise ending August 2016, for taking the considerable construction risk and continuing operations of the tunnel. Toll increases have to be agreed between the Chief Executive in Council and the NHKTC. If agreement cannot be reached, an arbitrator will make the final decision.
- (4) When the franchise was granted to the NHKTC in 1986, the financial plan included regular toll increases of \$5 for private cars/taxis, and proportionate increase for the other categories of vehicles, at 5-yearly intervals beginning from 1992/1993 till 2003. The Government indicated it wanted a toll regime that started at a relatively low level and grew over time.
- (5) In November 1992 and February 1994 the NHKTC’s calculations showed that a toll increase was necessary for it to earn a reasonable return over the life of the franchise and submitted applications to the Transport Branch (TB) for a toll increase. The TB did not support the applications. Under the circumstances, the NHKTC agreed to defer its toll increase application and review its financial situation annually.

- (6) In October 1995 the NHKTC made an application for a toll increase from HK\$10 for private cars to HK\$20. Its calculation showed that a \$20 toll would give a high probability of achieving a “reasonable return” over the life of the franchise without the need for further toll increases. The Executive Council did not agree, so an arbitrator was appointed in January 1996 to decide the case on its merits.
- (7) The arbitrator decided that (1) the appropriate measure of return was an IRR % return on equity after tax over the franchise period; (2) the lower level of a reasonable return was 15% and the upper level was 17%; (3) to be entitled to a toll increase, the NHKTC need not demonstrate that it had already fallen below this return, but rather that it will fall below this level over the franchise period; (4) it was the intention of the Government and the NHKTC that the tolls be raised gradually over the life of the franchise so that earlier tunnel users would not subsidize later users.
- (8) In accordance with these principles, the arbitrator awarded an increase of HK\$5 (to HK\$15) for private cars, and a proportionate increase for other vehicles, from 1 January 1998 and recommended future toll increases of HK\$5 at approximately 5-year intervals would be appropriate.
- (9) The 1998 toll increase was the NHKTC’s first and only toll increase since the commencement of operation of the EHT on 21 September 1989. 1 January 2003 is the time the arbitrator recommended a toll increase.

The case for a toll increase in 2003

- (10) Before making the application, the NHKTC compared the current situation of the EHT with that presented to the arbitrator. Many assumptions have not turned out as projected, however, in calculating the likely return on equity over the life of the Franchise, there is no combination of reasonable assumptions in which its return would get even close to the higher boundary of reasonable return. Most cases tested show a return below the lower band of a reasonable return established by the arbitrator
- (11) On 27 September 2002, the NHKTC applied to the Chief Executive in Council through the Secretary for Environment, Transport and Works (S for ETW) for a \$5 toll increase for private cars and proportionate increases

for other categories of vehicles, with effect from 1 January 2003. A schedule showing the existing and proposed toll is set out in Appendix.

- (12) On 17 October 2002, the NHKTC provided to the S for ETW detailed traffic and financial projections in support of its toll increase application and in November and December 2002 and January 2003 additional information to facilitate the processing of the Company's application, part of which is a presentation to the Transport Advisory Committee on 29 April 2003.
- (13) The NHKTC first paid a dividend in 1995, nine years after the EHT project began. Up to the end of 2002 the internal rate of return on equity was only 7%.
- (14) Based on NHKTC's financial projections and the traffic projections provided by experts in the field, the estimated IRR up to the end of the franchise after a \$5 increase on 1 January 2003 is 14.76%. Without the increase, the return will be 13.73%.
- (15) An IRR of 14.76% is below the lower boundary of the range of reasonable return of 15%, determined by the arbitrator.
- (16) Postponement of the proposed increase will mean a larger toll increase later to enable the NHKTC to achieve a reasonable return, which is undesirable, as it will create an unfair situation where later tunnel users subsidize earlier users.

Conclusion

- (17) The Company is following the decision of an independent arbitrator who took all relevant facts into consideration in coming to his decision. Unlike his award of a HK\$5 toll increase in 1998, his recommendations for future increases are not legally enforceable, but it would be a waste of substantial resources not to accept their moral force but to enter into another arbitration on the same issues.
- (18) The process of applying for a toll increase which the NHKTC initiated in September 2002, and is now presented by the Government to the Legislative Council, Transport Panel, sets a maximum toll that the

NHKTC may charge its customers. In making changes to the actual toll charged, the NHKTC will be mindful of the economic environment in which it operates.

New Hong Kong Tunnel Company Limited

23 June 2003

Appendix

**NEW HONG KONG TUNNEL COMPANY LIMITED
EXISTING AND PROPOSED TOLL SCHEDULE**

	Existing Toll \$	Proposed Toll \$
Private cars/taxis	15	20
Motorcycles	8	10
Light buses	23	30
Single decker buses	30	40
Double decker buses	45	60
Light goods vehicles	23	30
Medium goods vehicles	30	40
Heavy goods vehicles	45	60
Extra Axle	15	20