

Your ref.: CB1/SS/4/04

28 April 2005

The Hon. Lau Kong-wah, JP
Chairman of the Subcommittee
Panel on Transport
c/o Legislative Council Secretariat
Legislative Council Building
8 Jackson Road, Central
Hong Kong

Dear Mr. Lau:

**Subcommittee to Study the Eastern Harbour Crossing Ordinance
(Amendment of Schedule) Notice 2005**

We refer to the LegCo Subcommittee meeting on Tuesday 26 April and your letter of the same date to the Secretary for the Environment, Transport and Works.

Our response to your questions are:

- (a) The Company's toll increase has already been deferred for one month from April 2005 and will be effective 1 May 2005 with the exception of empty taxis and light buses. Toll for empty taxis will remain at \$15 until the end of June and the new toll for light buses will not be effective until 1 October 2005. The Company does not consider further deferral of the toll increase is in the best interests of the Eastern Harbour Tunnel users as further deferral will mean a larger increase in the future. This was explained by our Chairman at the Panel meeting on 22 April a copy of whose remarks were distributed at the time.
- (b) As requested, the following extracts from the Company's loan agreements with the lending banks, which show the restrictions imposed on the Company's dividend distribution, are enclosed for your information.
 - (i) Extract from a Master Credit Agreement dated 16th January 1987 pages 1 to 4 showing the definition of various terms; pages 40 to 44 clauses 12.1 to 12.6 showing the restrictions imposed on the Company's dividend distribution and how various ratios and tests are defined. (total 10 pages including cover)

- (ii) Extract from the Tolls Account Assignment in relation to a Master Credit Agreement dated 16th January 1987, pages 1 to 9 clauses 1 to 7 showing the covenants of the Borrower (i.e. the Company) with the lenders and how the Tolls Account into which all the Company's receipts were deposited was to be operated and the various restrictions on its use. (total 10 pages including cover)

The dividend policy all along adopted by the Company is to distribute all available cash as dividends to its shareholders. The Company's dividend distributions were restricted by the loan covenants and its retained earnings before the loan was repaid in 2001. Actual dividend distributions during these periods were the maximum allowed under the agreements. After the loan was repaid in 2001, the Company has been distributing all its surplus cash as dividends to shareholders on a monthly basis. This can be seen in the enclosed balance sheet and profit and loss account for the years from 1989 to 2003 extracted from the Company's audited financial statements.

As shown in the profit and loss account, the Company started to have positive retained earnings at the end of the financial year 1993 and declared its first dividend in year 1994. It distributed almost all of its retained earnings in 1994, 1995 and 1996. The Company's dividend distributions for the period/ years ended 31 December 1997, 1998, 1999 and 2000 were limited by the amount of Cash Available for Dividends for the years as defined in the loan agreements and certified by the Company's external auditors. The auditors' certificates and schedule 2 of the financial information showing the amount of Cash Available for Dividends for each of the period/year ended 1997 to 2000 are enclosed for your information. For your easy reference, we append below a table showing the amounts of Cash Available for Dividends and dividend distribution for each of these years.

<u>Year</u>	<u>Cash Available for Dividend</u>	<u>Dividend distribution</u>
	HK\$M	HK\$M
1997	137.77	137.25
1998	217.98	217.50
1999	124.47	123.75
2000	177.69	177.00

After the loan was repaid in 2001, the Company has been distributing all its surplus cash as dividends to shareholders. As a result, the Company's cash balance dropped significantly from the level of \$276 million in 2000 to \$40 million in 2001, \$26 million in 2002 and \$43 million in 2003.

The above analysis clearly shows that the alleged manipulation of financial data and use of financial management techniques by the Company for achieving a higher rate of toll increase is incorrect and totally unfounded.

We would also like to draw your attention to the letter of 25 April 2005 from our Chairman Mr Vernon Moore which was not reviewed at the meeting on 26 April. It included a statement by the NHKTC's financial expert – Mr Kenneth Morrison, senior

partner of Moores Rowland Mazars Certified Public Accountants - that Dr So's methodology was not correct, and included extracts from the standard book on financial analysis of investments. Dr Raymond So's analysis did not factor into his calculation the time value of money which is essential in any type of investment analysis. A copy of Mr Moore's letter is attached for your convenience.

- (c) At the meeting Dr So suggested that the Company should obtain loans to pay increased dividends.

It is axiomatic that debt should only be used to finance cash generative assets. Borrowing to pay dividends is not prudent financial management. Moreover, additional finance costs will be paid that will ultimately be borne by our customers. The major asset held by the Company is the tunnel and the franchise rights.

Any borrowing will certainly require the assignment of the tunnel and the franchise right to the lenders. Section 9 and 10 of the Eastern Harbour Crossing Ordinance (EHCO) prohibits such assignment under any agreement for purposes other than for securing the payment for the designing and carrying out of the construction works; the undertaking of any obligation imposed on the company by the EHCO, the project agreement or the operating agreement or such other purposes as the Financial Secretary may, by prior notice in writing to the company permits.

Since the franchise will expire in 11 years, it is most unlikely that the Company would be able to secure a loan without any collateral for the payment of dividends to shareholders, and even if it could, it would be imprudent to do so.

We hope that this letter explains clearly the actual situation in respect to the issues raised at the meeting. As the questions are becoming quite technical, if there are further questions we would appreciate their being provided in writing with a clear analysis of the underlying issue.

May I repeat that the analyses – both traffic and financial – presented to the arbitrators were agreed by all the experts involved to be correctly compiled using appropriate principles.

Yours sincerely,
NEW HONG KONG TUNNEL CO. LTD.

Becky Fung
Project Manager

Encl.

c.c. Secretary for the Environment, Transport and Works

Annex

A copy of this document is kept at the Legislative Council Library.
Please contact the Legislative Council Library if you wish to refer to this document.