

LEGISLATIVE COUNCIL PANEL ON TRANSPORT

Application for Toll Increase by Tate's Cairn Tunnel Company Limited

PURPOSE

Tate's Cairn Tunnel Company Limited (TCTC) has applied for an increase in tolls. This paper seeks Members' views on the application.

BACKGROUND

2. TCTC was granted a franchise under Tate's Cairn Tunnel Ordinance (Cap. 393) (the Ordinance) to build and operate the Tate's Cairn Tunnel for 30 years starting from July 1988, inclusive of the construction period. The tunnel was opened to traffic in June 1991. TCTC's franchise will expire in July 2018.

3. Section 36(3) of the Ordinance 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 party may resort to arbitration. The Ordinance has not set out the criteria for determining toll adjustments. It only 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 Ordinance.

TCTC'S APPLICATION FOR TOLL INCREASE

4. So far, Tate's Cairn Tunnel has had three toll increases which

came into effect in May 1995, November 1996 and January 2000 respectively. TCTC applied for its fourth toll increase in October 2000. On the advice of the Administration, the application was deferred three times due to the poor economic situation over the past few years.

5. On 5 October 2004, TCTC revived its toll increase application and submitted a set of updated financial projections and traffic forecasts in support of its application. The existing tolls and new tolls proposed by TCTC are as follows –

	Motor-cycles	Private car & taxi	Light bus and light goods vehicle	Medium and heavy goods vehicle	Single-decker bus	Double-decker bus	Extra axle
Existing Tolls	\$10	\$10	\$17	\$20	\$20	\$20	\$13
Proposed Tolls	\$10	\$12	\$18	\$23	\$24	\$26	\$15
Increase %	0%	20%	6%	15%	20%	30%	15%

TCTC's Financial Position

6. By the end of June 2004, TCTC had accumulated losses of \$453 million, representing a shortfall of \$1,476 million as compared with the expected cumulative profit of \$1,023 million in the base case projection. The difference between the actual profit/losses of TCTC and base case projections over the years is set out below –

Profit & Loss (in \$million)			
Year¹	Base Case Projection (A)	Actual Profit/Losses (B)	Difference (B-A)
1991/92	(149.3)	(175.5)	(26.2)
1992/93	(148.2)	(159.0)	(10.8)
1993/94	(147.2)	(147.0)	0.2
1994/95	(68.8)	(143.0)	(74.2)
1995/96	(55.6)	(93.8)	(38.2)
1996/97	41.1	(70.6)	(111.7)
1997/98	66.4	(43.1)	(109.5)
1998/99	87.7	(41.5)	(129.2)
1999/2000	193.6	(10.1)	(203.7)
2000/01	211.8	17.6	(194.2)
2001/02	265.4	92.2	(173.2)
2002/03	355.8	103.4	(252.4)
<i>Deferred tax adjustment²</i>	-	119.6	119.6
2003/04	370.5	97.5	(273.0)
Cumulative	1023.2	(453.3)	(1476.5)

¹ TCTC's financial year is from 1 July to 30 June of the following year.

² The deferred tax adjustment was a result of the adoption of a revised accounting standard.

7. In 1999 when the Administration considered TCTC's last toll increase application, the Company was in a critical financial position in that it had cashflow problems in meeting its scheduled bank loan repayment. The cashflow position of TCTC has since been improving. TCTC started to make a profit in the year 2000/01. According to the Company, the bank loan was fully repaid in October 2004.

Internal Rate of Return

8. In planning its franchise bid in 1988, TCTC assumed that the project would generate an Internal Rate of Return (IRR) of 13.02% over the 30-year franchise period. In support of its present application, TCTC has submitted forecasts showing that with the toll increases (including the current application and six projected future increases during the life of the franchise), it would only be able to achieve an IRR of 7.62% over the 30-year franchise period. If no toll increase is to be made before the end of the franchise, TCTC will achieve an IRR of 3.87%.

Reasons for Financial Underperformance

9. The financial underperformance was mainly attributable to lower toll revenue as the traffic volume through the Tunnel had been lower than the traffic forecast in the franchise bid. TCTC attributes the lower-than-expected toll revenue to the following –

- (a) relocation of the airport to Chek Lap Kok;
- (b) relocation of industrial/manufacturing activities from Hong Kong to the Mainland;
- (c) inability to increase tolls in accordance with TCTC's planned schedule; and
- (d) prolonged economic difficulties in recent years.

ISSUES TO CONSIDER

(A) Guiding Principle – Reasonable but not Excessive Remuneration

10. On the basis of the Base Toll Proposal which accompanied its franchise bid, TCTC expected that it would achieve an IRR of 13.02% over the 30-year franchise period. In considering TCTC's franchise bid in 1988, the Government agreed to the initial tolls but gave no undertaking in respect of subsequent toll adjustments. Neither was there any agreement on a guaranteed rate of return. TCTC's targeted IRR is the lowest among the four Build-Operate-Transfer tunnels in Hong Kong. The Route 3 (Country Park Section) aims at a targeted IRR of 15.18%, while the targets for the Eastern Harbour Crossing and the Western Harbour Crossing are both 16.5%. As set out in paragraph 8 above, TCTC projects that with the toll increases (including the current application and six subsequent projected increases during the life of the franchise), it will be able to achieve an IRR of 7.62% over the 30-year franchise period. If no toll increase is to be made before the end of the franchise, TCTC will only achieve an IRR of 3.87%.

(B) Traffic Implications

11. Currently, Tate's Cairn Tunnel has an average daily throughput of 61,200, against its design capacity of 78,500. During the morning peak hours, its throughput is above its capacity, with a vehicle/capacity ratio of 1.2. TCTC has estimated that with its proposed toll increases, about 940 and 260 vehicles will be diverted to Lion Rock Tunnel (LRT) and Tai Po Road respectively per day. This will aggravate the traffic congestion along the two roads, especially LRT which is already stretched beyond its capacity, with an average daily throughput of 89,000 compared to the design capacity of 78,500. According to TCTC, one of the key assumptions in planning the franchise bid in 1988 was that the tolls for LRT would be raised broadly in line with inflation. This scenario has not materialized. An increase in the toll differential between Tate's Cairn

Tunnel and LRT, following TCTC's proposed toll increase, will further aggravate the situation. Nevertheless, the KCRC Ma On Shan Rail, which started operation in December 2004, and Route 8 between Cheung Sha Wan and Shatin, which is scheduled for commissioning in 2007, will help relieve the traffic congestion at LRT.

(C) Arbitration

12. As mentioned above, if an agreement on the toll increase cannot be reached between the Government and TCTC, either party may resort to arbitration under the Arbitration Ordinance. There is therefore a chance that TCTC may resort to arbitration if its application for the toll increase is rejected. There will be cost implications to the Government should TCTC choose to resort to arbitration.

ADVICE SOUGHT

13. Members' views are invited on the toll increase application submitted by TCTC.

Environment, Transport and Works Bureau
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