

LEGISLATIVE COUNCIL BRIEF

Tate's Cairn Tunnel Ordinance
(Chapter 393)

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

INTRODUCTION

At the meeting of the Executive Council on 7 June 2005, the Council ADVISED and the Acting Chief Executive ORDERED that the Tate's Cairn Tunnel Company Limited (TCTC)'s application for toll increase should be approved, and that the new tolls should take effect from 1 August 2005.

JUSTIFICATIONS

Background

2. TCTC was granted a franchise under the Tate's Cairn Tunnel Ordinance (the Ordinance) to build and operate Tate's Cairn Tunnel for 30 years starting from July 1988, inclusive of the construction period. The tunnel was built at a cost of \$1.96 billion and was opened to traffic in June 1991. The franchise granted to TCTC 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 TCTC. 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 TCTC is reasonably but not excessively remunerated for its obligations under the Ordinance. A copy of section 36 of the Ordinance is at **Annex A**.

TCTC’s Application for Toll Increase

4. So far, Tate’s Cairn Tunnel has had three toll increases that came into effect in May 1995, November 1996 and January 2000 respectively. TCTC applied for its fourth toll increase in October 2000. At the request of the Environment, Transport and Works Bureau, TCTC agreed to defer the application three times due to the poor economic situation in the past few years.

5. In October 2004, TCTC revived its toll increase application. It originally aimed to have the new tolls effected on 1 January 2005. The existing tolls and new tolls proposed by TCTC are set out below –

	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 projection¹. The difference between the actual profit/losses of TCTC and base case projections over the years is set out below.

¹ The base case projection refers to the traffic, toll revenue and profit/loss projections included in TCTC's franchise bid, on which the expected IRR of 13.02% was derived.

Profit & Loss (in \$million)			
Year²	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 adjustment³</i>	-	119.6	119.6
2003/04	370.5	97.5	(273.0)
Cumulative	1023.2	(453.3)	(1476.5)

7. In 1999 when we considered TCTC's last toll increase application, it 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 improved. TCTC started to make a profit in 2000/01. According to TCTC, even if the tolls are to remain at the current level without any toll increase, the accumulated loss will be wiped off by 2008/09, with an accumulated profit of \$34 million by the end of that year.

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. If no toll increase is to be made until the end of the franchise, TCTC will only achieve an IRR of 3.87%. Based on the financial data available, we estimate that even if TCTC's current toll increase application is effected, it will only achieve an IRR of 4.9%. If, however, there were six further toll increases after the current one, TCTC will be able to achieve an IRR of 7.62%.

² TCTC's financial year is from 1 July to 30 June of the following year.

³ The deferred tax adjustment was a result of the adoption of a revised accounting standard.

Reasons for Financial Underperformance

9. TCTC considers that the financial underperformance has been caused by lower-than-expected toll revenue because the traffic volume through the tunnel has been lower than the traffic forecast in the franchise bid. A comparison of its base case forecast in the franchise bid and the actual traffic throughput is shown below –

Daily Average Traffic Volume (in thousands)			
Year⁴	Base Case Forecast	Actual	Difference
1991/92	64.7	56.6	-12%
1992/93	69.2	68.7	-1%
1993/94	73.8	79.6	+8%
1994/95⁵	78.3	80.7	+3%
1995/96⁵	82.9	75.5	-9%
1996/97	87.0	71.9	-17%
1997/98	90.6	69.5	-23%
1998/99	93.1	62.5	-33%
1999/2000	93.8	64.1	-32%
2000/01	93.8	64.0	-32%
2001/02	93.8	63.5	-32%
2002/03	93.8	61.5	-34%
2003/04	93.8	61.2	-35%

10. 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 to the Mainland;
- (c) inability to increase tolls in accordance with TCTC’s planned schedule; and
- (d) prolonged economic difficulties in recent years.

⁴ TCTC’s financial year is from 1 July to 30 June of the following year.

⁵ Two toll increases took effect on 1 May 1995 and 1 November 1996 respectively.

Administration’s Assessment

(A) Guiding Principle – Reasonable but not Excessive Remuneration

11. In considering TCTC’s Base Toll Proposal in 1988, we agreed to the initial tolls but gave no undertaking in respect of subsequent toll adjustments. Neither was there any agreement on a targeted or expected IRR. However, based on the Base Toll Proposal that accompanied its franchise bid, we understand TCTC expected that it would achieve an IRR of 13.02% over the 30-year franchise period. This is in fact 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%. The initial toll and TCTC’s expectation on subsequent toll levels in its Base Toll Proposal are as follows –

Category of Vehicles	Initial Toll	TCTC’s Own Expectations on Subsequent Toll Levels				
	July 1991	July 1994	July 1996	July 1999	July 2002	July 2005
Private cars, taxis and motorcycles	\$4	\$6	\$8	\$10	\$13	\$15
Light buses and light goods vehicles	\$7	\$10	\$14	\$17	\$23	\$26
Medium and heavy goods vehicles and buses	\$8	\$12	\$16	\$20	\$26	\$30
Extra axle	\$5	\$8	\$10	\$13	\$16	\$20

(B) Traffic Implications

12. Currently, the 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 ratio⁶ 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 each day. This will aggravate the traffic congestion along the two roads, especially LRT, which is already stretched beyond its capacity⁷. According to TCTC, one of the

⁶ A vehicle/capacity (v/c) ratio is normally used to reflect traffic situation during peak hours. A v/c ratio equals to or less than 1 means that the road has sufficient capacity to cope with the volume of traffic. A v/c ratio above 1 indicates the onset of mild congestion and a v/c ratio between 1 and 1.2 indicates a manageable degree of congestion.

⁷ LRT’s design capacity is 78,500 vehicles per day. At present, LRT’s average daily traffic throughput is 88,300 on weekdays and 79,800 on weekends.

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 the Tate's Cairn Tunnel and LRT will further aggravate the situation. It must however be noted that the Ma On Shan Rail (MOSR) commissioned in December 2004 has helped reduce some of the vehicles⁸ using LRT. In addition, we envisage that Route 8 between Shatin and Cheung Sha Wan scheduled for commissioning in late 2007 should help further relieve the traffic congestion at LRT.

(C) Arbitration

13. As mentioned above, if an agreement on the toll increase cannot be reached between the Government and TCTC, either party may resort to arbitration. There is therefore a chance that TCTC may resort to arbitration if its application for the toll increase is rejected.

IMPLICATIONS OF THE PROPOSAL

14. The financial and economic implications of the proposed toll increase are in **Annex B**. The proposed toll increase is in conformity with the Basic Law, including the provisions concerning human rights. It has no environmental, sustainability or civil service implications.

PUBLIC CONSULTATION

15. The Transport Advisory Committee (TAC) was consulted on TCTC's application for toll increase in November and December 2004. Taking into account all relevant factors⁹, the TAC advised that TCTC's current application for toll increase was justified. TAC considered that if no toll increase were to be made, an IRR of 3.87% would fall short of what would amount to a "reasonable but not excessive remuneration" for such a large-scale and long-term infrastructure investment. With the current application and another six future toll increases set out in TCTC's application, an IRR of 7.62% would represent a reasonable but not excessive return. Nevertheless, TAC considered that this did

⁸ The daily average numbers of vehicles using the LRT on weekdays and holidays during the first three months after the commissioning of MOSR (i.e. January – March 2005) are 88,300 and 79,800 respectively, representing a reduction of 2,000 and 2,900 vehicles compared with the same period in 2004.

⁹ Including definition and interpretation of what amounts to "reasonable but not excessive remuneration", financial position of TCTC, the current economic conditions of Hong Kong as well as any material changes in the economic conditions since the last toll increase, traffic impact of the proposed toll increase, and public acceptability.

not mean that the six projected toll increases should be accepted and that each application had to be considered in the light of the then prevailing circumstances. TAC's detailed advice is set out in its letter to the Secretary for Environment, Transport and Works at **Annex C**.

16. The Legislative Council Panel on Transport was consulted in February 2005. The following motion was passed -

“In view of the gradually improving financial position of TCTC, the Panel considered it inappropriate to increase the tunnel tolls at this stage”.

PUBLICITY

17. A press release will be issued on 10 June 2005. A spokesman will be made available to handle media enquiries. TCTC will also issue a separate press release on the same day.

ENQUIRIES

18. Any enquiries concerning this brief can be directed to Ms Elizabeth Tai, Principal Assistant Secretary for the Environment, Transport and Works, at 2189 2182.

Environment, Transport and Works Bureau
June 2005

LEGISLATIVE COUNCIL BRIEF

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(Chapter 393)

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List of Annexes

- Annex A - Section 36 of the Tate's Cairn Tunnel Ordinance (Cap. 393)
- Annex B - Implications of TCTC's Proposed Toll Increase
- Annex C - TAC's Advice

Chapter: 393 Title: TATE'S CAIRN Gazette
TUNNEL Number:
ORDINANCE
Section: 36 Heading: Company to charge Version Date: 30/06/1997
approved tolls for
use of tunnel

PART VIII

COLLECTION OF TOLLS

- (1) Subject to this Ordinance, the Company may demand and collect tolls in respect of the passage of motor vehicles through the 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 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 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 Company of its obligations, or the exercise of its rights, under this Ordinance is reasonably but not excessively remunerative to the 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 Company made under section 53;
 - (c) any material change in any other circumstances affecting the exercise by the Company of its rights under the franchise;
 - (d) the effect of the introduction of, or alteration in, any tax or levy imposed on the use of the tunnel;
 - (e) the project agreement; and
 - (f) any other relevant matter.

(5) In determining for the purposes of subsection (4) whether the carrying out by the Company of its obligations, or the exercise of its rights has been reasonably but not excessively remunerative to the Company, the arbitrators shall, if there has been any failure by a guarantor under the further guarantee agreement to comply with the terms of that agreement, deem the Company to be in the financial position it would have been in had the further guarantee agreement been honoured, and subject to this subsection nothing in that subsection shall be deemed to render such failure a relevant matter which the arbitrators may take into consideration.

(6) Where under subsection (3)-

- (a) the Governor in Council and the Company agree to a variation of the tolls; or
- (b) in an award pursuant to a 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.

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

Implications of TCTC's Proposed Toll Increase

Financial Implications

If TCTC's proposed toll increase is approved by Chief Executive-in-Council, the estimated additional royalty revenue to be paid to the Government will be about \$1.9 million, these estimates have taken into account the diversionary impact of the toll increase on existing traffic, on the basis of the estimated traffic flow using Tate's Cairn Tunnel in 2005-06. TCTC's annual total royalty payment to the Government will be increased to \$16.9 million as a result.

Economic Implications

2. Given that tolls for using the Tate's Cairn Tunnel constitute an insignificant proportion of average household spending, TCTC's proposed toll increase would have a minimal lifting effect on the Consumer Price Index.



本會檔號 Our Ref.
來函檔號 Your Ref.

15 February 2005

Dr Sarah Liao, JP
Secretary for the Environment, Transport and Works
10/F, Citibank Tower
3 Garden Road
Central, Hong Kong

Dear Dr Liao,

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

The Transport Advisory Committee has examined in detail the toll increase application submitted by the Tate's Cairn Tunnel Company Limited (TCTC). This letter sets out the Committee's views and advice to the Chief Executive-in-Council.

In considering the application, Members took the view that all relevant factors and circumstances should be taken into account. The first and foremost is the definition and interpretation of what amount to "reasonable but not excessive remuneration". Other factors include the financial position of TCTC, the current economic conditions of Hong Kong as well as any material change in it since the last toll increase in January 2000, the traffic impact that would be brought about by the proposed toll increase and last but not the least, the public acceptability of the proposed toll increase.

Members noted that while the cashflow position of TCTC had been improving since the last toll increase in January 2000, the Company had only just managed to repay its bank loan in October 2004 and had accumulated a loss of \$453 million for the first 16 years of operation.

In submitting its franchise bid in January 1988, TCTC had assumed that the project would generate an Internal Rate of Return (IRR) of 13.02% over the 30-year franchise period. The construction cost for the tunnel was in the sum of \$1,962 million. Members were informed that the projected IRR of 13.02% was not an agreed figure. Nonetheless, it is the lowest targeted IRR amongst the four Build-Operate-Transfer tunnels in Hong Kong.

Based on the current forecast, if no toll increase is to be made, TCTC would achieve an IRR of 3.87%. Members are of the view that an IRR of 3.87% would fall short of what would amount to a "reasonable but not excessive remuneration" for such a large scale and long term infrastructure investment.

If the current application is acceded to, then with the other six projected toll increases set out in its application, TCTC would achieve an IRR of 7.62%. This percentage would, in Members' view, represent a reasonable but not excessive return in the current situation. It is less than the projected IRR when TCTC submitted its franchise bid but nonetheless would reasonably remunerate TCTC as envisaged in the franchise agreement and Tate's Cairn Tunnel Ordinance. Members observed that this does not mean that the six projected toll increases should be accepted or seen as being agreed to or that the IRR of 7.62% is accepted for future applications. Each application has to be considered in the light of the then prevailing circumstances.

Members noted TCTC's claim that it had been affected by the sluggish economy in the past few years but felt that such impact was applicable to many businesses and was not unique to TCTC. Members were also mindful of the possible public reaction to the proposed toll increase and the financial impact on road users. However, given the changing economic conditions in Hong Kong and the entitlement of TCTC to a reasonable but not excessive remuneration, a balance had to be struck. With this, the right of TCTC to refer the application for toll increase to arbitration must not be overlooked. If the toll increase is

justifiable, it is much better from an overall perspective to reach an agreement with TCTC than to incur public spending by way of legal costs in resolving such differences through contentious proceedings.

From the traffic management perspective, Members noted that with the proposed toll increase, about 940 and 260 vehicles would be diverted to the Lion Rock Tunnel and Tai Po Road respectively each day. This might aggravate the traffic congestions along the two roads, especially the Lion Rock Tunnel. Nevertheless, Members considered that the KCRC Ma On Shan Line should help relieve the traffic congestion and again the question is one of striking the right balance.

After weighing all the above factors, the Committee concluded that TCTC's current application for toll increase is justified. I should be grateful if you would convey this Committee's advice to the Chief Executive-in-Council.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Teresa Cheng", with a decorative flourish underneath.

(Ms Teresa Cheng)
Chairman
Transport Advisory Committee