

For information
on 7 June 2010

Legislative Council Panel on Financial Affairs

**Supplementary Provision to Head 106 – Miscellaneous Services
Subhead 284 – Compensation**

PURPOSE

This paper informs Members that the Government will seek the approval of the Finance Committee (FC) for a supplementary provision of \$80 million to *Head 106 Miscellaneous Services - Subhead 284 Compensation* arising from the judgment handed down by the Lands Tribunal (LT) on 30 November 2009 (LT's Judgment) allowing the rating and Government rent appeals lodged by the Hongkong Electric Company Limited (HEC) for the assessment year of 2004-05 and also the decision handed down by the LT on 12 April 2010 (LT's Decision) awarding interest to HEC. In the said appeals, HEC appealed against the Commissioner of Rating and Valuation's (CRV) assessments of the rateable values (RVs) of its electricity supply system¹.

BACKGROUND

Assessment of rates and Government rent

2. Rates and Government rent are charged at a percentage (currently at 5% and 3% respectively) of a property's RV. The RV is an estimate of the annual rental value of a property at a designated reference date, assuming that the property was then vacant and available for letting in the open market. Under the Rating Ordinance (Cap. 116) (RO) and the Government Rent (Assessment and Collection) Ordinance (Cap. 515) (GRACO), any ratepayer who is not satisfied with the RV of his property can object to CRV. If a person is dissatisfied with CRV's decision on the objection, he may lodge an appeal with the LT.

¹ An electricity supply system includes the land and buildings on which it is situated, as well as rateable plant and machinery, which are considered as property subject to RV assessment.

3. The RO and the GRACO provide that rates and Government rent must be paid as demanded, or else surcharges may be imposed. Besides, rates and Government rent shall remain payable even if the amount concerned is under dispute, unless a holding over is granted by CRV for the whole or part of the payment.

4. Holdover of rates and Government rent payment is, however, rarely granted. The upfront payment requirement has the effect of deterring payers from defaulting on or delaying rates and Government rent payment simply by appealing against the RVs in often lengthy litigations. This is an important measure to protect Government's revenue.

HEC's Appeals

5. In October 2004, HEC lodged appeals to the LT against CRV's assessment of the RVs of its electricity supply system. The appeal cases were subsequently adjourned. In early 2008, HEC applied to restore its appeals for the years of 2004-05 and the three years immediately following (i.e. the years of 2005-06, 2006-07 and 2007-08). The LT only allowed the appeals for the year of 2004-05 to proceed to hearing with the appeals for the other assessment years stayed. The appeals for the years of 2008-09 and 2009-10 were lodged and subsequently adjourned also pending the outcome of the 2004-05 appeals.

6. The CRV's original RV assessments of the HEC's electricity supply system were based on the Receipts and Expenditure method (i.e. anticipated receipts less expenses and operator's return), in which the operator's cost of capital is adopted to estimate its return. In the LT's Judgment, the LT allowed HEC's appeal and set down the methodology for valuing the subject system using the Receipts and Expenditure method, but also using the return permitted in HEC's Scheme of Control Agreement to estimate its return instead of the operator's cost of capital used in the original RV assessments. As a result, a substantial reduction in RVs had to be made.

7. The LT further awarded HEC interest on the overpaid rates and Government rent in LT's Decision at HEC's actual borrowing rates² for the pre-judgment period and the judgment rate³ for the post-judgment period.

² 3.19%, 4.63%, 4.38%, 4.19%, 1.97% and 1.64% respectively in the calendar years from 2004 to 2009.

³ The prevailing judgment rate is 8%.

8. The Government has appealed to the Court of Appeal (CA) against the LT's Judgment on the RVs but has decided not to appeal against LT's Decision in respect of the interest payment. Pending the determination of the Government's said appeal by the CA, which was fixed to be heard on 26 July 2010, and without prejudice to the Government's position in the appeal, the Government is liable to refund HEC the overpaid rates and Government rent, and pay the associated interest.

9. In order to reduce the Government's interest exposure, the overpaid rates and Government rent for the test year of 2004-05, being \$117.45 million and \$30.58 million respectively, were refunded to HEC from the respective revenue accounts (Head 2 General Rates – Subhead 030 General Rates and Head 7 Properties and Investments – Subhead 090 Government rents charged at 3% of rateable values in accordance with the Government Rent (Assessment and Collection) Ordinance (Cap.515)). The associated interest in the amount of about \$26.54 million chargeable to ***Head 106 Miscellaneous Services - Subhead 284 Compensation*** was paid to HEC.

HEC's Appeals for the Years of 2005-06 to 2009-10

10. As explained in paragraph 5 above, HEC's appeals lodged for the other assessment years of 2005-06 to 2009-10 have been adjourned pending the outcome of the appeals for the test year of 2004-05. While awaiting the outcome of and without prejudice to the Government's said appeal before the CA, the Government has followed the methodology as decided in the LT's Decision on the HEC's remaining appeals in order to reduce the Government's potential interest payments. In early May 2010, the overpaid rates and Government rent for the years of 2005-06 to 2007-08 were refunded to HEC from the respective revenue accounts. The associated interest amounting to \$45.70 million would need to be settled as soon as possible in order to reduce the Government's interest exposure.

11. In respect of the appeals for the years of 2008-09 and 2009-10, the Government has yet to reach an agreement with HEC on the amounts of overpaid rates and Government rent but it is estimated that the associated interest would be about \$7 million.

Insufficient Provision under Head 106 Miscellaneous Services - Subhead 284 Compensation

12. The approved provision for 2010-11 under ***Head 106 Miscellaneous Services - Subhead 284 Compensation*** for settlement of claims (other than compensation connected with land, public works and mail, and for civil servants under the Employees' Compensation Ordinance), court ordered payment, settlement out of courts and for certain ex-gratia payments made against Government is \$70 million. As this is the first court order requiring payment of interest associated with overpaid rates and Government rent and LT's Decision was only handed down on 12 April 2010, no provision for this kind of interest payment was made for 2010-11 under the relevant Subhead. Provision will be made for similar payments where circumstances warrant in the said Subhead in future years as appropriate.

13. As at 31 May 2010, the relevant Subhead has a remaining balance of \$26.87 million, which is insufficient to cover the Government's potential liability in respect of the above interest payments in 2010-11. Supplementary provision is therefore required. A table setting out the requested provision is at **Annex**.

WAY FORWARD

14. The Government will seek the approval of the FC for a supplementary provision of \$80 million to ***Head 106 Miscellaneous Services - Subhead 284 Compensation***.

**Financial Services and the Treasury Bureau
May 2010**

**Supplementary Provision to
Head 106 – Miscellaneous Services
Subhead 284 Compensation**

	\$'000
(a) Interest in connection with the appeals in year 2004-05	26,540
(b) Estimated provision for interest regarding the appeals in years 2005-06 to 2007-08	45,700
(c) Estimated provision for interest regarding the appeals in years 2008-09 and 2009-10	7,000
Total	79,240 [say, 80,000]