

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 23 June 2015, the Council **ADVISED** and the Chief Executive **ORDERED** that the Tate's Cairn Tunnel Company Limited ("TCTCL")'s application for toll increase should be approved, and that the new tolls should take effect from 1 January 2016.

JUSTIFICATIONS

Background

2. TCTCL was granted a franchise under the Tate's Cairn Tunnel Ordinance ("the Ordinance") (Chapter 393) to build and operate Tate's Cairn Tunnel ("TCT") 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. TCTCL's franchise will expire in July 2018.

3. According to section 36(3) of the Ordinance, the tolls may be varied by agreement between the Chief Executive-in-Council ("CE-in-C") and the tunnel company. If an agreement cannot be reached, either party may submit the case to arbitration.

TCTCL's Application for Toll Increase

4. So far, TCTCL has had seven toll increases which came into effect on 1 May 1995, 1 November 1996, 2 January 2000, 1 August 2005, 30 November 2008, 25 December 2010 and 1 August 2013 respectively. In all previous seven toll increase applications, the Government and the TCTCL were able to reach agreement without resorting to arbitration. The last toll increase at TCT was effected on 1 August 2013, with a \$2 increase for all types of vehicles and additional axle in excess of two (except for motorcycles), and \$1 increase for motorcycles. The then weighted average rate of toll increase was 11.1%.

5. TCTCL submitted on 23 September 2014 an application for the eighth toll increase at TCT to take effect on 1 August 2015 as follows –

- (a) \$3 increase for all types of vehicles and additional axle in excess of two (“additional axle”), except for motorcycles; and
- (b) \$2 increase for motorcycles.

The magnitude of toll increase for different vehicle types ranges from 9% to 18%, and the weighted average rate of toll increase is 15%¹. Such toll increase will enable the company to achieve a nominal Internal Rate of Return on equity after tax (“IRR”) of 6.91% over the 30-year franchise period.

6. Upon receipt of TCTCL's toll increase application, the Government urged the company to reconsider the need for the toll increase and whether the proposed magnitude of increase was appropriate. The Government further persuaded the company to reduce the magnitude of the proposed toll increase, in particular minimising the impact of the proposed toll increase on public transport vehicles (namely public light buses and buses) as well as goods vehicles. TCTCL subsequently revised its proposal on 26 March 2015 and agreed to reduce the magnitude of the proposed toll increase as follows –

¹ The weighted average rate of toll increase represents the percentage increase in total toll revenue calculated based on the proposed toll rates and the actual traffic of TCT.

- (a) no increase for public light buses, and all types of goods vehicles;
- (b) \$1 increase for single-decker and double-decker buses;
- (c) \$2 increase for motorcycles and private light buses; and
- (d) \$3 increase for private cars, taxis and every additional axle.

Under the revised toll increase proposal, the percentage of increase ranges from no increase for public light buses and goods vehicles to 18% for private cars and taxis, with a weighted average rate of toll increase of 11.9%. TCTCL also agreed to defer the effective date of the proposed toll increase to 1 December 2015. Further, TCTCL undertook in writing not to apply for any more toll increase during the current franchise period.

7. The above revised proposal was discussed at the meeting of the Legislative Council Panel on Transport (“LegCo Panel”) on 17 April 2015. Having regard to the views expressed by LegCo Panel members and after further negotiation with the Government, TCTCL submitted a further revised proposal on 21 April 2015, which proposes not to increase the toll for private light buses and to provide \$3 promotional discount for empty taxis between midnight and 6 a.m. for three months after the new tolls become effective, subject to further review. The existing tolls and new tolls proposed by TCTCL are as follows –

	Motor-cycles	Private cars & taxis	Private light buses	Public light buses	Light goods vehicles	Medium & heavy goods vehicles	Single-decker buses	Double-decker buses	Additional axle
Existing Tolls	\$13	\$17	\$24	\$23	\$24	\$28	\$31	\$34	\$21
<i>Original Proposed Tolls in September 2014</i>	<i>\$15</i>	<i>\$20</i>	<i>\$27</i>	<i>\$26</i>	<i>\$27</i>	<i>\$31</i>	<i>\$34</i>	<i>\$37</i>	<i>\$24</i>
<i>Increase % (Increase magnitude)</i>	<i>15% (\$2)</i>	<i>18% (\$3)</i>	<i>13% (\$3)</i>	<i>13% (\$3)</i>	<i>13% (\$3)</i>	<i>11% (\$3)</i>	<i>10% (\$3)</i>	<i>9% (\$3)</i>	<i>14% (\$3)</i>

	Motor-cycles	Private cars & taxis	Private light buses	Public light buses	Light goods vehicles	Medium & heavy goods vehicles	Single-decker buses	Double-decker buses	Additional axle
Revised Proposed Tolls in March 2015	\$15	\$20	\$26	\$23	\$24	\$28	\$32	\$35	\$24
Increase % (Increase magnitude)	15% (\$2)	18% (\$3)	8% (\$2)	0% (-)	0% (-)	0% (-)	3% (\$1)	3% (\$1)	14% (\$3)
Further Revised Proposed Tolls in April 2015	\$15	\$20	\$24	\$23	\$24	\$28	\$32	\$35	\$24
Increase % (Increase magnitude)	15% (\$2)	18% (\$3)	0% (-)	0% (-)	0% (-)	0% (-)	3% (\$1)	3% (\$1)	14% (\$3)

8. The Transport Advisory Committee (“TAC”) was consulted on the further revised proposal mentioned in paragraph 7 in April 2015. A briefing paper prepared for TAC by TCTCL on its toll increase application is at **Annex A**. When deliberating TCTCL’s toll increase application, TAC made a number of suggestions for TCTCL’s consideration. Members suggested that TCTCL consider not increasing the tolls during off-peak hours to help retain the traffic which would otherwise be diverted to Lion Rock Tunnel (“LRT”) and other alternative routes. Members also suggested that TCTCL consider running the \$3 promotional discount for empty taxis between midnight and 6 a.m. for a longer period, and that the Government request TCTCL to provide a deed of undertaking to confirm that it would not submit any further toll increase application before the franchise expires. TAC’s detailed advice on the toll increase application is set out in **Annex B**.

9. Upon further discussion with the Government on TAC’s suggestions above, TCTCL agreed to extend the \$3 promotional discount for empty taxis for another three months (i.e. six months in total), with the possibility of further extension subject to review. TCTCL also issued a letter signed by its Chairman to the Government confirming its undertaking that it would not submit any further toll increase application before the expiry of the franchise. As regards the suggestion of not increasing the tolls during

off-peak periods, TCTCL expressed difficulties in taking it on board. This was because TCTCL, given the technical limitation of its existing toll collection system, had operational difficulty in collecting differential tolls for all vehicle types during off-peak hours. An off-peak hour discount (i.e. no toll increases) would also create confusion at the toll collection counters. For example, drivers might argue that they were actually queuing up for toll payment before the end of the off-peak periods.

10. When assessing the public affordability and acceptability in respect of a toll increase application, the cumulative change in the Composite Consumer Price Index (“CCPI”) since the last toll increase will be compared to the weighted average rate of toll increase. The weighted average rate of the proposed toll increase (i.e. the version put forth by TCTCL in April 2015) is 11.9%. Based on the CCPI of April 2015 released by the Census and Statistics Department on 21 May 2015 and the Government’s forecast of 3.2% increase in CCPI for 2015 as stated in the First Quarter Economic Report 2015, the cumulative change in CCPI since the last toll increase from 1 August 2013 up to end November 2015 is estimated to be 11.8%. The weighted average rate of the proposed toll increase would thus be higher than the cumulative change in the CCPI based on the latest estimate. The Government further discussed with TCTCL who replied in May 2015 to agree postponing the implementation date from 1 December 2015 to 1 January 2016².

TCTCL’s Financial Performance

11. By the end of June 2014, TCTCL had accumulated profit of \$1,283 million, representing a shortfall of \$4,057 million as compared with the expected cumulative profit of \$5,340 million in the company’s base case projection when bidding for the franchise. The difference between the actual profit/loss of TCTCL and base case projections over the years is set out below –

² The cumulative change in CCPI since the last toll increase from 1 August 2013 up to end December 2015 is estimated to be 12.1%, which is higher than the weighted average rate of the proposed toll increase (i.e. 11.9%).

Profit & Loss (in \$million)			
Year (from 1 July to 30 June)	Base Case Projection (A)	Actual Profit/Loss (B)	Difference (B-A)
1991/92	(149)	(176)	(27)
1992/93	(148)	(159)	(11)
1993/94	(147)	(147)	0
1994/95	(69)	(143)	(74)
1995/96	(56)	(94)	(38)
1996/97	41	(71)	(112)
1997/98	66	(43)	(109)
1998/99	88	(41)	(129)
1999/2000	194	(10)	(204)
2000/01	212	18	(194)
2001/02	265	92	(173)
2002/03	356	103	(253)
Deferred tax adjustment ³	-	120	120
2003/04	370	97	(273)
2004/05	372	112	(260)
2005/06	448	142	(306)
2006/07	447	146	(301)
2007/08	446	157	(289)
2008/09	446	156	(290)
2009/10	443	177	(266)
2010/11	442	189	(253)
2011/12	427	208	(219)
2012/13	425	212	(213)
2013/14	421	238	(183)
Cumulative	5,340	1,283	(4,057)

TCTCL started making an operating profit in 2000/01. It repaid its bank loan in October 2004 and shareholders' loan in 2004/05. It wiped off the accumulated loss by 2007/08, and had an accumulated profit of \$1,283 million at the end of 2013/14. The company started to pay dividends in 2008/09.

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

Reasons for Financial Underperformance

12. TCTCL attributes the lower-than-expected toll revenue to the following –

- (a) increasing toll disparity between LRT and TCT (according to TCTCL, one of the key assumptions in planning the franchise bid in 1988 was that the tolls for LRT would be adjusted broadly in line with that of TCT's. This scenario has not materialised.);
- (b) diversion effect due to an increase in transportation modes and road choices; and
- (c) migration of industrial/manufacturing activities to the Mainland.

A comparison of its base case traffic forecast in the franchise bid and the actual traffic throughput is shown below –

Daily Average Traffic Volume (in thousands)			
Year (from 1 July to 30 June)	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%
1994/95 ⁴	78.3	80.7	+3%
1995/96	82.9	75.5	-9%
1996/97 ⁴	87.0	71.9	-17%
1997/98	90.6	69.5	-23%
1998/99	93.1	62.5	-33%
1999/2000 ⁴	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%
2004/05	93.8	60.0	-36%

⁴ Seven toll increases took effect in May 1995, November 1996, January 2000, August 2005, November 2008, December 2010 and August 2013 respectively.

Daily Average Traffic Volume (in thousands)			
Year (from 1 July to 30 June)	Base Case Forecast	Actual	Difference
2005/06 ⁴	93.8	55.3	-41%
2006/07	93.8	55.6	-41%
2007/08	93.8	56.4	-40%
2008/09 ⁴	93.8	51.5	-45%
2009/10	93.8	51.5	-45%
2010/11 ⁴	93.8	53.0	-43%
2011/12	93.8	54.6	-42%
2012/13	93.8	56.2	-40%
2013/14 ⁴	93.8	55.7	-41%

The Government's Assessment

(A) *Guiding Principle – Ensuring a Reasonable but not Excessive Remuneration to TCTCL*

13. While the Ordinance has not set out the criteria for determining toll adjustments, section 36(3) stipulates that if the CE-in-C and the tunnel franchisee cannot agree on a toll variation, the matter can be submitted for arbitration. Section 36(4) stipulates that the arbitrators shall be guided by the need to ensure that the tunnel company is reasonably but not excessively remunerated, having regard to, inter alia, any material change in the economic conditions since the tolls were last determined. A copy of section 36 of the Ordinance is at **Annex C**.

14. In considering previous toll increase applications from TCTCL, the IRR is considered an indicator to determine whether the tunnel franchisee was reasonably but not excessively remunerated. On the basis of the Base Toll Proposal which accompanied its franchise bid submitted in 1988, TCTCL expected that it would achieve a nominal IRR of 13.02% over the 30-year franchise period. In considering TCTCL's franchise bid in 1988, the Government agreed to the initial tolls but gave no undertaking in respect of subsequent toll adjustments. Nor was there any agreement on a guaranteed rate of return.

15. TCTCL's target nominal IRR was the lowest among the four Build-Operate-Transfer tunnels in Hong Kong. Route 3 (Country Park Section) had a target nominal IRR of 15.18%, while the targets for the Eastern Harbour Crossing ("EHC") and the Western Harbour Crossing were both 16.5%. As things stand, TCTCL will only achieve a nominal IRR of 6.81% (or a real IRR of 3.40%) over the 30-year franchise period if no toll increase were made before the expiry of the franchise. TCTCL projects that it will be able to achieve a nominal IRR of 6.91% over the 30-year franchise period should the further revised toll increase application (as set out in paragraphs 7 to 10 above) be approved, and implemented on 1 January 2016.

16. While the Ordinance has not stipulated what constitutes "reasonable but not excessive remuneration" for TCTCL, we could make reference to the previous arbitration rulings on the toll increase applications by the franchisee of EHC, which has a similar toll adjustment and arbitration mechanism as TCT. In the first two EHC toll increase arbitrations in 1997 and 2005, it was ruled that a reasonable but not excessive remuneration to the EHC franchisee fell within a range of nominal IRR of 15% to 17%. In the third arbitration in 2012, the arbitrators considered that it was appropriate to take account of the financial or economic changes such as that in the inflation rates prevailing in Hong Kong over the life of the franchise since the relevant assumptions were made in the franchise bid. The arbitrators were of the view that at the then toll levels, the EHC franchisee would have enjoyed a real IRR (i.e. 9.09%) substantially in excess of the forecast (around 6.5% or 6.8% real IRR), and that no further increase in tolls was necessary or appropriate. An award in favour of the Government was given in the third arbitration. Considering that TCT was a large-scale and long term infrastructure, a nominal IRR of 6.91% (or a real IRR 3.49%) would not be unreasonable nor excessive in financial and investment terms, having regard to the return achieved by the EHC franchisee.

17. Under the Ordinance, if an agreement on the toll increase cannot be reached between the CE-in-C and TCTCL, either party may resort to arbitration under the Arbitration Ordinance (Chapter 609). Therefore, TCTCL has the right to resort to arbitration if its application for the toll increase is rejected by the CE-in-C. In all previous seven toll increase applications, the CE-in-C and TCTCL were able to reach agreement and arbitration has never been resorted to. In this context, TAC has advised that it would be desirable for the two parties to reach an agreement on the toll

increase where possible rather than to incur public expenditure by way of legal costs in resolving their differences through arbitration.

(B) Public Affordability and Acceptability

18. As mentioned in paragraph 10 above, in assessing public affordability and acceptability, the weighted average rate of toll increase is compared to the cumulative change in the CCPI since the last toll increase up to TCTCL's proposed effective date of the toll increase (i.e. 1 January 2016). The Government has reminded TCTCL of the importance of paying due regard to public affordability and acceptability in devising their tolling strategy. Under TCTCL's latest revised toll increase proposal (i.e. the version put forth by TCTCL on 21 April 2015), the percentages of increase range from no increase for public light buses, private light buses, and goods vehicles to 18% for private cars and taxis, with a weighted average rate of toll increase of 11.9%. This is lower than the cumulative change in CCPI since the last toll increase from 1 August 2013 up to end December 2015, which is estimated to be 12.1%⁵. (As stated in paragraph 10 above, had TCTCL not agreed to defer the toll increase implementation date from 1 December 2015 to 1 January 2016, the cumulative change in CCPI will be 11.8% up to end November 2015.) The above considerations notwithstanding, the further revised toll increases, in particular that for private cars and taxis, may still incur criticisms by some members of the public.

(C) Traffic Assessment

19. In 2014, TCT had an average daily throughput of 57 000 vehicles, against its design capacity of 78 500 vehicles. TCTCL has estimated that with its proposed toll increase, about 700 vehicles per day will be diverted to LRT (which runs largely parallel to TCT), about 100 vehicles per day will be diverted to Tai Po Road, and about 300 vehicles per day will be diverted to Route 8 between Cheung Sha Wan and Shatin respectively. Our assessment is that the traffic impact of the proposed toll increase on the road system linking Shatin and Kowloon would unlikely be significant and commuters have a choice of alternate routes as well as alternative transport modes.

⁵ The figure is estimated based on the CCPI of April 2015 released by Census and Statistics Department on 21 May 2015 and the Government's forecast of 3.2% increase in CCPI for 2015 as stated in the First Quarter Economic Report 2015.

(D) Service Performance and Operating Cost

20. According to TCTCL's annual survey of customers' opinions in 2014, over 98% of the customers surveyed considered TCTCL's service satisfactory. TCTCL has been reducing its operating costs (excluding rates and royalty paid to the Government) over the past 17 years, from about \$86 million in 1996/97 to about \$70 million in 2013/14. While TCT is the longest road tunnel in Hong Kong, its operating costs per kilometer of tunnel are the lowest among all Build-Operate-Transfer tunnels. Since staff costs and utility costs account for the major portion of the operating costs, the scope for further significant cost savings is small.

Timing of Implementation

21. The CE-in-C has approved the latest revised application for toll increase to take effect on 1 January 2016. The 2015-16 Legislative session will resume in mid-October 2015. There will be sufficient time for the gazette notice⁶ to be made by the Commissioner for Transport in accordance with section 36(7) of the Ordinance to go through the Legislative Council's negative vetting process.

IMPLICATIONS OF THE PROPOSAL

22. The financial and economic implications of the proposed toll increase are at **Annex D**. The proposed toll increase is in conformity with the Basic Law, including the provisions concerning human rights. It has no environmental, sustainability, productivity, competition, family, gender or civil service implications.

PUBLIC CONSULTATION

23. TCTCL's revised toll application was discussed at the LegCo Panel meeting on 17 April 2015. LegCo Panel members expressed strong objection to the proposed toll increase. There were suggestions that TCTCL

⁶ Under section 36(7) of the Ordinance, the gazette notice (a legal notice) is to be made by the Commissioner for Transport as soon as practicable after an agreement between CE-in-C and the tunnel company on toll variation referred to in section 36(6) is made.

should consider withdrawing its toll increase proposals for buses, taxis, motorcycles and private light buses as well as providing discounts for empty taxis. Several members were concerned that the proposed toll increase would cause motorists to switch to use the LRT which charges lower toll, thus aggravating the congestion thereat. One member considered that the proposed toll increase would induce a spate of fare increases by other public transport operators. After the LegCo Panel meeting, the Government continued to urge TCTCL to consider its toll increase proposal in light of the comments of the LegCo Panel members. TCTCL submitted on 21 April 2015 a further revised toll increase application entailing two concessions, as mentioned in paragraph 7 above.

24. As mentioned in paragraphs 8 to 9, TAC was consulted on TCTCL's application of 21 April 2015 and made three suggestions during its deliberation of the matter. The Government had conveyed TAC's suggestions to TCTCL for consideration. TCTCL took on board two of the three suggestions (paragraph 9 refers). After weighing all relevant factors⁷, TAC is of the view that TCTCL's current application for toll increase is not unreasonable and is justified. TAC's detailed advice is set out in its letter dated 9 June 2015 to the Secretary for Transport and Housing at **Annex B**.

PUBLICITY

25. A press release will be issued before the publication of the gazette notice by the Commissioner for Transport on 3 July 2015.

ENQUIRIES

26. Any enquiries concerning this Brief can be directed to Ms Cordelia Lam, Principal Assistant Secretary for Transport and Housing, at 3509 8192.

Transport and Housing Bureau July 2015

⁷ These factors include TCTCL's financial position, operating costs, service performance, public affordability and acceptability, and whether TCTCL is obtaining reasonable but not excessive remuneration, as well as traffic implications.

TATE'S CAIRN TUNNEL COMPANY LIMITED

TOLL INCREASE APPLICATION

Briefing Paper for Transport Advisory Committee

Justification for Toll Rise

Tate's Cairn Tunnel (TCT) franchise was awarded on a "Build, Operate Transfer" (BOT) basis to attract investment from private sector for building infrastructure project in Hong Kong. About \$2 billion was invested to build the TCT. The TCT Ordinance has stated that a "reasonable but not excessive return" should result from this investment.

As at the end of June 2014 (i.e. after a period of 26 years since the start of the 30-year franchise in 1988), Tate's Cairn Tunnel Company Limited ("TCTC") has accumulated profit of \$1,283 million, lagging far behind the Base Toll Proposal in which an accumulated profit of \$5,340 million had been projected with the expected IRR of 13.02%. The deviation resulting from shortfalls in revenue was due to reasons beyond the Company's control.

TCTC has eliminated its accumulated loss in its 20th year. Note that another comparable project, the Eastern Harbour Tunnel, eliminated its accumulated loss in its 7th year.

Tolls constitute TCTC’s core income and account for about 96% (2013/14) of TCTC’s total revenue. The proposed toll increase as set out below is expected to generate additional revenue eventually to achieve a reasonable investment return.

Vehicle category	Current toll	Proposed Toll	Increase amount
Motorcycle	\$13	\$15	\$2
Private car & taxi	\$17	\$20	\$3
Public light bus	\$23	\$23	-
Private light bus	\$24	\$24	-
Light goods vehicle	\$24	\$24	-
Medium & heavy goods vehicle	\$28	\$28	-
Single-decker bus	\$31	\$32	\$1
Double-decker bus	\$34	\$35	\$1
Extra axle	\$21	\$24	\$3

Expected Effective Date

1 Dec 2015

Under the pressure of the accumulated shortfall in traffic revenue, much effort has been put into cost control. TCTC has reduced its operating costs (excluding rates and royalty paid to the Government) over the past seventeen years; from about \$86 million in 1996/97 to about \$70 million in 2013/14. Even though TCT is the longest road tunnel in Hong Kong, TCTC’s operating costs compare very favourably with other BOT tunnels. These cost reductions are not achieved through employee redundancy programs or by lowering service standards.

Traffic Implications

According to the latest forecasts, the toll increase currently proposed by TCTC would cause only slight traffic diversion to Lion Rock Tunnel (about 700 vehicles daily), Tai Po Road (about 100 vehicles daily) and Route 8 (about 300 vehicles daily). Hence, there would not be significant traffic impact resulting from TCTC’s currently proposed toll increase.

Service Performance

From TCTC’s annual survey of customers’ opinions, it is noted that customers’ overall satisfaction rating has been maintained at a high level in recent years:

<u>Year</u>	<u>Satisfaction Rating</u>
2010	95.6%
2011	97.6%
2012	98.2%
2013	97.6%
2014	98.2%

Prepared by:

Tate’s Cairn Tunnel Company Limited
April 2015



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9 June 2015

Professor the Honourable Anthony Cheung, GBS, JP
Secretary for Transport and Housing
22/F, East Wing
Central Government Offices
2 Tim Mei Avenue
Tamar
Hong Kong

Dear Professor Cheung,

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

The Transport Advisory Committee ("TAC") examined in detail the toll increase application submitted by the Tate's Cairn Tunnel Company Limited ("TCTCL") at its meeting on 28 April 2015. This letter sets out TAC's views on the application and its advice to the Chief Executive-in-Council.

Members of TAC noted that TCTCL submitted its original toll increase application to the Government on 23 September 2014 and, after negotiation with the Government, a revised one on 26 March 2015. In formulating its revised toll increase application, TCTCL had sought to minimise the impact of the toll increases on public transport vehicles and goods vehicles. The percentage of the toll increases under the revised proposal ranged from no increase for public light buses and goods vehicles to 18% for private cars and taxis, with a weighted average rate of toll increase of 11.9%. TCTCL also undertook in the toll application that if the application was acceded to, it would not submit further toll increase application during the franchise period.

Members were informed that TCTCL submitted on 21 April 2015 a further revised proposal after another round of negotiation with the Government and having regard to the views of the members of the Panel on Transport of the Legislative Council made at its meeting of 17 April 2015. The concessions entailed in the further revised toll increase application were that TCTCL agreed (i) not to increase the toll for private light buses, and (ii) to provide \$3 promotional discount for empty taxis between midnight and 6 a.m. for three months after the new tolls become effective, subject to further review. The weighted average rate of toll increase under the further revised proposal remains at 11.9%.

In considering TCTCL's toll increase application, TAC took all relevant factors and circumstances into account, including the TCTCL's financial position, operating costs, service performance, public affordability and acceptability, and whether TCTCL was obtaining reasonable but not excessive remuneration, as well as traffic implications. Its findings and views are summarised below.

Members noted that although the financial performance of TCTCL improved in the last decade, it only wiped off the accumulated loss by 2007/08, and started to pay dividends in 2008/09, which was almost about 20 years after the commencement of its franchise. Members were informed that TCTCL had adopted various measures to reduce its operating costs (down from about \$86 million in 1996/97 to about \$70 million in 2013/14), and that TCTCL's operating costs per kilometer of tunnel was the lowest among all Build-Operate-Transfer tunnels.

Members also noted that in submitting the franchise bid in 1988, TCTCL expected that it would achieve a nominal Internal Rate of Return on equity after tax ("IRR") of 13.02% over the 30-year franchise period. Nonetheless, because of the lower-than-expected toll revenue over the years as a result of a number of factors, TCTCL was only able to achieve a nominal IRR of 6.81% so far. If the further revised toll increase application is acceded to, TCTCL would achieve a nominal IRR of 6.91% over the franchise period. Considering that Tate's Cairn Tunnel was a large-scale and long term infrastructure, a nominal IRR of 6.91% would not be unreasonable nor excessive in financial and investment terms, having regard to the return achieved in other similar franchise.

When considering public affordability and acceptability, Members noted that the weighted average rate of TCTCL's further revised toll increase application of 11.9% was slightly lower than the cumulative change in Composite Consumer Price Index since TCTCL's last toll increase from 1 August 2013 and up to end November 2015, which was estimated to be 12.4% as at early April 2015.

From a traffic management perspective, Members noted that about 700 vehicles per day would be diverted to Lion Rock Tunnel, about 100 vehicles per day would be diverted to Tai Po Road, and about 300 vehicles per day would be diverted to Route 8 between Cheung Sha Wan and Shatin respectively under the further revised toll increase application. The traffic impact on the road system linking Shatin and Kowloon would unlikely be significant, and motorists and commuters would have a choice of alternate routes as well as alternative transport modes.

When deliberating on TCTCL's toll increase application, Members had also made a number of suggestions for TCTCL's consideration. Members suggested that TCTCL should consider not increasing the tolls during off-peak hours to help retain the traffic which would otherwise be diverted to other alternative routes. This might even help improve TCTCL's financial position. Members also suggested that TCTCL should consider running the promotion scheme for empty taxis for a longer period, and that the Government should request TCTCL to provide a deed of undertaking to confirm that it would not submit any further toll increase application before the franchise expired.

Members noted that the Government had conveyed the above TAC's suggestions to TCTCL for consideration. TCTCL has now agreed to further extend the \$3 promotional discount for empty taxis for another three months (making it six months in total, subject to further review). TCTCL also issued a letter signed by its Chairman to the Government confirming its undertaking. As regards the suggestion of not increasing tolls during off-peak periods, TCTCL expressed difficulties in taking it on board. This was because TCTCL had operational difficulty in collecting differential tolls for all vehicle types during off-peak hours in

view of the technical limitation of its existing toll collection system. An off-peak hour discount (i.e. no toll increases) would also create confusion at the toll collection counters. For example, drivers might argue that they were actually queueing up for toll payment before the expiry of the off-peak periods. Members noted the TCTCL's replies.

While Members well understood that any toll increases would not be readily welcomed by the public, they were aware of the right of TCTCL to resort to arbitration as provided in the governing legislation. Should the toll increases be considered generally not unreasonable, it would be desirable, where possible, for the two parties to reach an agreement on the toll increases rather than to incur public spending on legal costs in resolving such differences through arbitration.

After weighing all relevant factors, TAC is of the view that TCTCL's current application for toll increase is not unreasonable and is justified in the circumstances. I should be grateful if you would convey TAC's advice to the Chief Executive-in-Council.

Yours sincerely,



(Larry Kwok)
Chairman

Transport Advisory Committee

Annex C

Chapter: 393	Title:	TATE'S CAIRN TUNNEL ORDINANCE	Gazette Number:	L.N. 38 of 2011
Section: 36	Heading:	Company to charge approved tolls for use of tunnel	Version Date:	01/06/2011

(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 609) by either the Governor in Council or the Company. (Amended 17 of 2010 s. 112)

(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.

(Enacted 1988)

Implications of TCTCL's Proposed Toll Increase

Financial Implications

If TCTCL's application for toll increase is to take effect on 1 January 2016, the estimated royalty revenue to be paid to the Government in 2015/16 will increase by \$1.02 million from \$24.45 million to \$25.47 million.

Economic Implications

2. Given that tolls for using TCT constitute an insignificant proportion of average household spending, TCTCL's proposed toll increases would have minimal effect on inflation.