

Legislative Council on Transport

Tate's Cairn Tunnel Company Limited Application for Toll Increase

PURPOSE

The Tate's Cairn Tunnel Company Limited (TCTC) has applied for an increase in tolls. This paper seeks Members' views on the TCTC's application and the Government's counter-proposal as set out in paragraph 17.

BACKGROUND

2. TCTC was granted a franchise under the Tate's Cairn Tunnel Ordinance (Cap. 393) ("the Ordinance") to build and operate the Tate's Cairn Tunnel for 30 years from July 1988, inclusive of the construction period. The tunnel was opened to traffic in June 1991. The franchise is now in its 12th year and expires in July 2018.

The Toll Increase Application

3. TCTC submitted an application on 26 May 1999 for an increase in tolls to come into effect as soon as possible. This is TCTC's third application since the commencement of its operation. The last two toll increases were approved and implemented on 1 May 1995 and 1 November 1996 respectively.

4. The existing tolls and new tolls proposed by TCTC are as follows :-

	Private cars, taxis & motorcycles	Light buses and light goods vehicles	Medium & heavy goods vehicles and buses	Extra axle
Existing Tolls	\$8	\$13	\$20	\$7
Proposed Tolls	\$15	\$17	\$27	\$15
Increase %	+88%	+31%	+35%	+114%

TCTC's Financial Position

5. TCTC claims that it is in a critical financial position. It has made losses in all eight years of its operational history. The accumulated loss of the company at the end of the 1998/99 financial year stood at \$873 million. As the accumulated loss has exceeded the \$600 million original shareholders' equity, shareholders had to make additional injections totalling \$105 million up to June 1999 to finance the ventilation improvement project and repayment of bank loans.

Debt Servicing Requirements

6. Tate's Cairn Tunnel was built with bank loans amounting to over \$1 billion. Without the toll increases, TCTC will not have enough net cash receipts from toll revenue to shoulder this burden. TCTC claims that it has difficulties persuading lending banks to accept deferral of repayments without the prospects of toll increases.

Internal Rate of Return

7. 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 proposed toll revisions, it will be able to achieve an IRR of 11.7% over the 30-year franchise period. This is still falling short of TCTC's own expected IRR of 13.02%.

Operating Costs

8. TCTC has been successful in controlling its operating expenses for the past two consecutive years, with 6.6% reduction in 1997/98 and 4.6% reduction in 1998/99.

Reasons for Underperformance

9. Traffic volume through Tate's Cairn Tunnel has been lower than TCTC's expectation. The deviation has become particularly acute in recent years. TCTC attributes the lower than expected financial performance to a number of factors beyond its control :-

- (a) the lower than expected growth in population and employment in North East New Territories;
- (b) the number of goods vehicles using the tunnel being far less than the company's original projections. The average daily throughput of goods vehicles in 1998/99 was 14,368 as against the original forecast of 37,838. TCTC attributes the shortfall to the cheaper toll chargeable by the Lion Rock Tunnel (a flat toll of \$6 for all vehicle types before 1 April 1999, increased to \$8 thereafter) and the relocation of industries from Hong Kong to China which has reduced the demand for local goods vehicle trips;
- (c) relocation of the airport has reduced traffic through the tunnel; and
- (d) the recent economic downturn.

10. This is TCTC's third toll increase application since the commencement of its franchise. Section 36 of the Ordinance (**Annex**) provides that tolls can be revised by agreement between the CE in Council and the TCTC. Failing an agreement, TCTC can submit its case to arbitration under the Arbitration Ordinance (Cap. 341).

THE ADMINISTRATION'S ASSESSMENT

Guiding Principle - Reasonable but not Excessive Remuneration

11. The Ordinance itself does not specify the criteria for CE in Council to determine tolls. However, section 36(4) of the Ordinance stipulates that in case of an arbitration, the arbitrator shall be guided by the need to ensure that the carrying out by the company of its obligations and exercise of its rights under the Ordinance is reasonably but not excessively remunerative.

12. In the franchise bid which TCTC submitted in January 1988, TCTC put forward a Base Toll Proposal which would enable it to achieve an IRR of 13.02% over the 30-year franchise period. The initial tolls and TCTC's expectation on subsequent toll regimes in its Base Toll Proposal are as follows :-

	Initial Tolls	Expectations on Subsequent Toll Regimes				
	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 & heavy goods vehicles and buses	\$8	\$12	\$16	\$20	\$26	\$30
Extra axle	\$5	\$8	\$10	\$13	\$16	\$20

13. TCTC's expected IRR, at 13.02%, is in fact the lowest among the BOT tunnels in Hong Kong. The Route 3 (CPS) 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%.

Traffic Implications

14. Section 36 also allows the Government to take into account any other relevant matters and, in our view, these include traffic implications of the proposed toll increases. The Lion Rock Tunnel (LRT) is already congested during peak hours. TCTC has estimated that with its proposed toll increases, if implemented, 13,200 vehicles will be diverted to LRT (+11,600) and Tai Po Road (+1,600) per day. This will cause severe traffic congestions at LRT and its vicinity during peak hours.

Toll Differential with Lion Rock Tunnel

15. According to TCTC, 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 tolls for the Tate's Cairn Tunnel. This scenario has not materialized. The much higher tolls at TCTC has stifled potential traffic growth through the tunnel.

COUNTER-PROPOSAL

16. Given the present economic conditions, Government does not consider that the level of toll increases proposed by TCTC should be accepted. However, if the Government rejects the application entirely and does not allow any increase, the company will face cash flow problems unless its shareholders are prepared to inject further cash.

17. Taking into account the factors in paragraphs 10 to 15 above, we have counter-proposed to TCTC to reduce the proposed magnitude of toll increases. On the basis of TCTC's expectation of subsequent toll regimes in the Base Toll Proposal submitted in 1988, we have made a counter-proposal to TCTC that the company should reduce the magnitude of the proposed toll increases to the levels envisaged in its own Base Toll Proposal for the period of July 1999 to June 2002, as follows :-

	Private cars, taxis and motorcycles	Light buses and light goods vehicles	Medium & heavy goods vehicles and buses	Extra axle
Existing Toll	\$8	\$13	\$20	\$7
Government's Counter- Proposal (% Increase)	\$10 (+25%)	\$17 (+31%)	\$20 -	\$13 (+86%)
TCTC's Proposal (% Increase)	\$15 (+88%)	\$17 (+31%)	\$27 (+35%)	\$15 (+114%)

18. The Base Toll Proposal will generate additional toll revenue of about \$54 million in the year of 2000, which would help TCTC meet part of its short term financial obligations. This would also help the company in reaching a loan rescheduling plan with the lending banks. Some traffic diversion in the order of 3,500 vehicles for LRT is expected with minimal diversion to Tai Po Road and these should not cause any intolerable traffic problem. With reference

to TCTC's Base Case Forecast, the Base Toll Proposal is likely to generate an IRR in the region of 9%.

19. The counter-proposal has been accepted by TCTC. We intend to recommend that the new tolls will come into effect on Sunday 2 January 2000.

ECONOMIC IMPLICATIONS

20. As the tunnel tolls account for only a very small proportion of total household expenditure, the inflationary impact of the increase in line with Base Toll Proposal is not expected to have a significant impact. It is estimated that the Composite CPI will be increased by 0.09-0.1 percentage point if tolls are adjusted according to the counter-proposal.

ADVICE SOUGHT

21. Members are asked to give their views on the proposed toll increase application by TCTC and the Government's counter-proposal as set out in paragraph 17.

Transport Bureau
24 November 1999
[TBCR 1/4651/94(99) Pt.14]

Extract

Tate's Cairn Tunnel Ordinance (Cap. 393)

PART VIII

COLLECTION OF TOLLS

36. Company to charge approved tolls for use of tunnel

(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.