Legislative Council Panel on Commerce and Industry

Resolution of the Asset Transfer Arrangement under the Community Electronic Trading Service Agreement

Introduction

This paper seeks Members' support for a proposal to resolve the asset transfer arrangement under the Community Electronic Trading Service (CETS) Agreement between Government and Tradelink Electronic Commerce Ltd. ("Tradelink").

Background

2. In December 1992, the Government granted under the CETS Agreement an exclusive franchise to Tradelink for the provision of front-end Electronic Data Interchange (EDI) services to the trading community for six types of official trade-related documents. These documents are: restrained textile export licence (RTEL), import and export declarations (TDEC), certificate of origin (CO), production notification (PN), dutiable commodities permit (DCP) and cargo manifest (EMAN). Services for RTEL, TDEC, PN and CO have been rolled out in stages since 1997. Services for DCP and EMAN will be launched in early 2002.

3. Tradelink's franchise is for seven years, beginning from the start of its commercial operation in 1997 and expiring on 31 December 2003. In accordance with the CETS Agreement, Government and Tradelink should enter into negotiations on the continued provision on an exclusive basis by Tradelink after 2003 of the six services mentioned in paragraph 2 above. If no agreement is reached by 30 June 2002, Tradelink should transfer at the end of the franchise period to Government at zero cost the assets (and associated liabilities) necessary for the provision of those six services. This effectively gives Government a handle to take possession of the hardware and software necessary for the delivery of the services involved. The purpose is to provide Government with maximum flexibility in arranging for the provision of those services after Tradelink's franchise expires. As a quid pro quo, Tradelink is permitted to recoup all of its capital investments within the franchise period, adopting an accelerated depreciation policy as necessary.

4. To recoup all of its capital investment by the end of 2003, Tradelink has been adopting an accelerated depreciation policy for assets acquired in 1999 or later, instead of the normal 5-year depreciation policy.

5. Under the CETS agreement, Tradelink is permitted to set user charges at a level sufficient for it to obtain an internal rate of return not exceeding 18% over the franchise period. The initial level of charges (including projected charges over the franchise period) for each EDI service and any cumulative annual increases thereof in excess of 7% of the last approved projected charges are subject to the prior approval of Government. Based on Tradelink's latest forecast and the projected charges already approved by Government, Tradelink's internal rate of return will be below 6%.

Charges for existing services and new services

6. Tradelink's current and projected charges for the four existing services are as follows -

Service	2001 price ($)	2002 price ($)	2003 price ($)
RTEL	75.0	80.3	85.9
TDEC	12.9	13.9	14.9
CO	15.0	16.1	17.2
PN	16.1	17.2	18.4

7. The charges for the two services to be launched in 2002 - DCP and EMAN – have not yet been approved by Government. Applying the accelerated depreciation policy (paragraph 4 above) to derive the charges would result in significantly inflated figures. This is because the capital investments involved will have to be amortised within a period of about two years.

Arrangement for service provision after 2003

8. To introduce market competition, we plan to engage additional service providers after Tradelink's franchise expires in 2003. To ensure service continuity, we will continue to engage Tradelink as a service provider after 2003 on a non-exclusive basis. In February 2001, we consulted Members on this plan and obtained Members' support in principle.

Resolving the asset transfer arrangement

9. To implement the post-2003 arrangement would not require Government to take possession of Tradelink's assets. Indeed, it will be important for Tradelink to continue to use those assets in delivering services so that there will not be any disruption to customer service. Accordingly, we have been negotiating with Tradelink to resolve the asset transfer arrangement.

10. A fair and reasonable approach is for Tradelink to 'buy back' the assets due to be transferred to Government. The assets should not be reverted to Tradelink for free because they are of substantial value. On the other hand, instead of requiring Tradelink to pay Government in cash for buying back the assets, we propose that Tradelink should reduce or freeze its charges to users. The reasons for this proposal are as follows –

(a) since Tradelink is permitted to recoup all its capital investments from user charges within the franchise period, to an extent users are paying for the assets. It will be reasonable for users to enjoy the benefit arising from the buy-back arrangement; and

(b) a reduction or a freeze in charges would alleviate the cost burden on users in the current economic climate.

Valuation

11. To establish an objective basis to decide the buy-back price, Government and Tradelink have agreed to appoint an independent accountant firm to assess the value of Tradelink's assets to be transferred to Government. The valuation exercise has been completed. The value of the assets has been determined to be about $59 million.

Proposal

12. On the basis of the outcome of the valuation, and after further negotiations between Government and Tradelink, the following package has been tentatively agreed -

(a) Tradelink will freeze the charges for three of its existing services, i.e. TDEC, PN, and CO, at their 2001 levels for the remaining franchise period; and

(b) Tradelink will set the charges for new services to be launched in 2002, i.e. DCP and EMAN, based on the normal 5-year depreciation policy.

In addition, Tradelink will reduce its charge for RTEL from $75 to $65 with effect from January 2002 and introduce preferential prices for long-term customers using its DCP and EMAN services as follows :

	Original Prices under accelerated depreciation policy	Prices under normal depreciation policy	Preferential prices for long-term customers*
DCP	$76.5	$44.0	$11.0 on average
EMAN	$55.0	$28.6	$18.8 on average

Note (*) : Customers benefiting from the preferential rates must enter into a contract with Tradelink to use Tradelink's DCP and EMAN services in specified periods.

13. The total revenue forgone by Tradelink under the proposed package above is estimated to be $93.5 million over the remaining franchise period, broken down as follows –

TDEC, CO, and PN	$48.7 million
RTEL	$13.4 million
DCP	$13.7 million
EMAN	$17.7 million
Total :	$93.5 million

Way Forward

14. Subject to Members' support, we will put forward the proposed package in paragraph 12 above to Finance Committee for approval on 21 December 2001.

Commerce and Industry Bureau
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