

ITEM FOR FINANCE COMMITTEE

Head 106 – Miscellaneous Services Subhead 284 – Compensation

Members are invited to approve a supplementary provision of \$80 million under Head 106 Miscellaneous Services Subhead 284 Compensation to meet payment to Hongkong Electric Company Limited of around \$52.7 million as settlement of interest on overpaid rates and Government rent arising from a Lands Tribunal judgment, and to maintain sufficient provision in the Subhead for meeting other claims and payments that may arise in 2010-11.

PROBLEM

In a case of appeals by Hongkong Electric Company Limited (HEC) against the Commissioner of Rating and Valuation's (CRV) assessment of the rateable values (RVs) of HEC's electricity supply system¹ for the rate year 2004-05, the Lands Tribunal (LT) in its Judgment dated 30 November 2009 (the Judgment) allowed the appeal and specified a methodology for the assessment of such RVs; and in its Decision (the Decision) dated 12 April 2010 awarded interest to HEC on the overpaid rates and Government rent. We need to pay the associated interest.

PROPOSAL

2. The Secretary for Financial Services and the Treasury proposes to seek a supplementary provision of \$80 million to Head 106 Miscellaneous Services Subhead 284 Compensation for the payment of an estimated \$52.7 million as settlement of interest on rates and Government rent that, in accordance with the

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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.

methodology set down in the Judgment, have been over-collected from HEC during the rate years 2005-06 to 2009-10; and for maintaining sufficient provision in the Subhead for meeting other claims and payments that may arise in 2010-11.

JUSTIFICATION

HEC's Appeals

3. In October 2004, HEC lodged appeals to the LT against CRV's assessment of the RVs of its electricity supply system. As initiated by HEC, the adjournment of the appeals was, with the CRV's consent, approved by the LT in November 2004. 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 adjourned. 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.

4. In assessing the RVs of HEC's electricity supply system for 2004-05, RVD had used the method that it had been using for years for electricity supply systems. In the Judgment, the LT allowed HEC's appeals, and set down the methodology for valuing HEC's electricity supply system. The LT also directed the parties to agree on the proper form and terms of the order including the final figure on the RVs assessed in accordance with the methodology, and the resultant rates and Government rent of HEC's electricity supply system, to be drawn up for the appeals, with liberty to apply for further directions if necessary. In accordance with the methodology, the RVs of HEC's electricity supply system and therefore the rates and Government rent for 2004-05 are lower than those assessed by RVD. In its Decision dated 12 April 2010, the LT ordered RVD to pay HEC interest on HEC's overpaid rates and Government rent at HEC's actual borrowing rates² for the pre-judgment period and the judgment rate³ for the post-judgment period until full payment.

5. The Government has appealed to the Court of Appeal (CA) against the Judgment on questions of law but has decided not to appeal against the Decision regarding interest payment. The appeal has been fixed to be heard by CA in the last week of July 2010.

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

³ The prevailing post-judgment interest rate is 8% per annum.

6. Pending the determination of the Government's appeal by the CA and without prejudice to the Government's position in the appeal, in compliance with the LT's order we have refunded HEC the overpaid rates and Government rent for the test year of 2004-05, being \$117.45 million and \$30.58 million respectively, 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 RVs in accordance with the Government Rent (Assessment and Collection) Ordinance (Cap. 515)). Also in compliance with the LT's order and in order to reduce the Government's interest exposure, the associated interest in the amount of about \$26.54 million chargeable to Head 106 Miscellaneous Services Subhead 284 Compensation was paid to HEC.

7. As explained in paragraph 3 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. The Judgment is binding on the RVD and given that it has set down the methodology for valuing HEC's electricity supply system, we should follow the methodology for the assessment years of 2005-06 to 2009-10, pending the outcome of and without prejudice to the Government's appeal to the CA against the Judgment. Accordingly, 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. As for the years of 2008-09 and 2009-10, the Government has yet to reach an agreement with HEC on the exact amounts of overpaid rates and Government rent.

8. To follow the Decision and in order to reduce the Government's interest exposure, we should settle the interest associated with the above overpaid rates and Government rent as early as possible. For the years 2005-06 to 2007-08, the interest is about \$45.70 million. For 2008-09 and 2009-10, while we have yet to agree with HEC the amount of the overpaid rates and Government rent, we estimate that the associated interest would be about \$7 million.

Encl. 1 9. A table setting out the interest associated with the three periods mentioned above, with a total of around \$80 million, is at Enclosure 1. If the Government is successful in its appeal to the CA against the Judgment (paragraphs 5), HEC will have to return the over-refunded rates, Government rent and interest to the Government. The Government will also seek to claim interest for the over-refunded amount and interest paid to HEC.

10. Since the Judgment concerns a unique kind of tenement, i.e. electricity supply system regulated by a scheme of control, HEC's appeal cases are not expected to have implications beyond electricity-generating companies. Valuation of other general types of rateable properties, e.g. domestic flats and commercial properties will not be affected.

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FINANCIAL IMPLICATIONS

11. The payment for the interest is chargeable to Head 106 Miscellaneous Services Subhead 284 Compensation. The approved provision for 2010-11 under Head 106 Miscellaneous Services Subhead 284 Compensation is \$70 million. As the Decision was only handed down by the LT on 12 April 2010, no provision for the interest payment was made for 2010-11 under the relevant Subhead.

Encl. 2 12. As at 31 May 2010, Subhead 284 has a remaining balance of \$26.87 million (Enclosure 2), which is insufficient for payment of the interest for the years of 2005-06 to 2007-08 (\$45.70 million) and 2008-09 and 2009-10 (about \$7 million). We also need to maintain some provision in the Subhead for meeting other claims and payments that may arise in 2010-11. We therefore propose to seek a supplementary provision of \$80 million. Provision will be made for similar payments where circumstances warrant in the said Subhead in future years as appropriate.

PUBLIC CONSULTATION

13. The Legislative Council Panel on Financial Affairs discussed the proposal on 7 June 2010. Members noted that we would seek funding approval from the Finance Committee.

BACKGROUND

Assessment of rates and Government rent

14. Rates and Government rent are charged at a percentage (currently at 5% and 3% respectively) of a property's RV. Under the Rating Ordinance (Cap. 116) (RO) and the Government Rent (Assessment and Collection) Ordinance (Cap. 515) (GRACO), CRV is required to ascertain a property's RV, which 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 RO and GRACO, any person who is not satisfied with CRV's decision may lodge an appeal with the LT.

15. 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. The requirement to pay rates and Government rent as demanded protects

Government's revenue and discourages payers from defaulting on or delaying rates and Government rent payment simply by appealing against the RVs in often fairly lengthy litigations.

Ambit of Head 106 Subhead 284

16. Provision under Head 106 Miscellaneous Services Subhead 284 Compensation is 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.

Financial Services and the Treasury Bureau
June 2010

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

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

**Financial Position of
Head 106 – Miscellaneous Services
Subhead 284 Compensation**

| | \$'000 |
|---|---------------|
| (a) Approved provision for 2010-11 | 70,000 |
| (b) Actual expenditure from 1 April 2010 to 31 May 2010 | 38,900 |
| (c) Commitments as at 31 May 2010 | 4,230 |
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| Balance as at 31 May 2010 ((a) – (b) – (c)) | 26,870 |
