

LEGISLATIVE COUNCIL BRIEF

Tate's Cairn Tunnel Ordinance
(Chapter 393)

Application for Toll Increases by Tate's Cairn Tunnel Company Limited

INTRODUCTION

At the meeting of the Executive Council on 11 May 2010, the Council **ADVISED** and the Chief Executive **ORDERED** that the Tate's Cairn Tunnel Company Limited (TCTC)'s application for toll increase should be approved, and that the new tolls should take effect from 25 December 2010.

JUSTIFICATIONS

Background

2. TCTC was granted a franchise under the Tate's Cairn Tunnel Ordinance (the Ordinance) to build and operate the Tate's Cairn Tunnel 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. The franchise granted to TCTC will expire in July 2018.

3. Section 36(3) of the Ordinance provides that the tolls specified in the Schedule to the Ordinance may be varied by agreement between the Chief Executive-in-Council and TCTC. If an agreement cannot be reached, either party may resort to arbitration. The Ordinance has not set out the criteria for determining toll adjustments. It only stipulates that if the matter is submitted for arbitration, the arbitrator shall be guided by the need to ensure that TCTC is reasonably but not excessively remunerated for its obligations under the Ordinance. A copy of section 36 of the Ordinance is at **Annex A**.

TCTC's Application for Toll Increases

4. So far, the Tate's Cairn Tunnel has had five toll increases that came into effect in May 1995, November 1996, January 2000, August 2005 and November 2008 respectively. TCTC applied for its sixth toll increases in July 2009, proposing a \$1 toll increase for each vehicle category. Having regard to the views expressed by the Transport Panel of the Legislative Council and following further consultations with the Administration, TCTC submitted a revised application in January 2010. While maintaining its earlier proposal of a \$1 toll increase for most vehicle categories, TCTC proposes not to increase the toll for public light buses (PLBs) (and to provide \$1 promotional discount for empty taxis between midnight and 6 a.m). The revised toll increases range from 0% to 9% for different vehicle types. Details of the original and revised proposals are set out below –

	Motor-cycles	Private car & taxi	Private light bus & light goods vehicle	Public light bus	Medium & heavy goods vehicle	Single-decker bus	Double-decker bus	Extra axle
Existing Tolls	\$11	\$14	\$21	\$21	\$25	\$28	\$31	\$18
Original Proposed Tolls	\$12	\$15	\$22	\$22	\$26	\$29	\$32	\$19
Increase % (Increase magnitude)	9% (\$1)	7% (\$1)	5% (\$1)	5% (\$1)	4% (\$1)	4% (\$1)	3% (\$1)	6% (\$1)
Revised Proposed Tolls	\$12	\$15	\$22	\$21	\$26	\$29	\$32	\$19
Increase % (Increase magnitude)	9% (\$1)	7% (\$1)	5% (\$1)	0% (\$0)	4% (\$1)	4% (\$1)	3% (\$1)	6% (\$1)

TCTC's Financial Position

5. By the end of June 2008, TCTC had accumulated profit of \$103 million, representing a shortfall of \$2,633 million as compared with the expected cumulative profit of \$2,736 million in the company's base case projection when bidding for the franchise. The difference between the actual profit/losses of TCTC and base case projections over the years is set out below –

Profit & Loss (in \$million)			
Year¹	Base Case Projection (A)	Actual Profit/Loss (B)	Difference (B-A)
1991/92	(149)	(176)	(26)
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 adjustment²	-	120	120
2003/04	371	97	(273)
2004/05	372	112	(260)
2005/06	448	141	(307)
2006/07	447	146	(301)
2007/08	446	157	(290)
Cumulative	2,736	103	(2,633)

¹ TCTC's financial year is from 1 July to 30 June of the following year.

² The deferred tax adjustment was a result of the adoption of a revised accounting standard.

6. TCTC started to make an operating profit in 2000/01. It repaid its bank loan in October 2004 and shareholders' loan in 2004/05 after repayment of the bank loan. It also wiped off the accumulated loss by 2007/08, with an accumulated profit of \$103 million at the end of the year. TCTC started to pay dividends in 2008/09.

Reasons for Financial Underperformance

7. TCTC considers that the financial underperformance has been caused by lower-than-expected toll revenue due to the following –

- (a) increasing toll disparity between the Lion Rock Tunnel (LRT) and Tate's Cairn Tunnel (According to TCTC, one of the key assumptions in planning the franchise bid in 1988 was that the tolls for LRT would be increased broadly in line with inflation. This scenario has not materialised);
- (b) relocation of the airport to Chek Lap Kok;
- (c) relocation of industrial/manufacturing activities to the Mainland;
- (d) prolonged economic difficulties between 1998/99 and 2003/04; and
- (e) diversion effect due to an increase in transportation modes and road choices, the opening of Route 3 (Tai Lam Tunnel), Ma On Shan Railway and Route 8.

8. 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)			
Year³	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%
1994/95⁴	78.3	80.7	+3%
1995/96	82.9	75.5	-9%
1996/97⁴	87.0	71.9	-17%
1997/98	90.6	69.5	-23%
1998/99	93.1	62.5	-33%
1999/2000	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%
2005/06	93.8	55.3	-41%
2006/07	93.8	55.6	-41%
2007/08	93.8	56.4	-40%
2008/09	93.8	51.5	-45%

Administration's Assessment

(A) Guiding Principle – Reasonable but not Excessive Remuneration

9. In considering TCTC's Base Toll Proposal in 1988, we agreed to the initial tolls but gave no undertaking in respect of subsequent adjustments. Neither was there any agreement on a targeted or expected Internal Rate of Return (IRR). However, based on the Base Toll Proposal that accompanied its franchise bid, we understand TCTC expected that it would achieve an IRR of 13.02% over the 30-year franchise period. This is in fact the lowest among the four Build-Operate-Transfer tunnels in Hong Kong. If no toll increase is allowed, TCTC would achieve an IRR of 6.0% over the 30-year franchise period. The resulting IRR at 6.1% with the current toll increase would not be unreasonable or excessive in this perspective.

³ TCTC's financial year is from 1 July to 30 June of the following year.

⁴ Two toll increases took effect on 1 May 1995 and 1 November 1996 respectively.

(B) *Traffic Implications*

10. In 2009, the Tate's Cairn Tunnel had an average daily throughput of 50,600 vehicles, against a design capacity of 78,500. Based on its revised proposed toll increases, TCTC estimated that about 500 vehicles would be diverted to the LRT and 100 vehicles would be diverted to each of Tai Po Road (TPR) and Route 8 (between Cheung Sha Wan and Shatin) per day. It should be noted that Route 8, especially with the commissioning of the remaining section between Cheung Sha Wan and Tsing Yi in December 2009, provides an alternative route to LRT and TPR⁵. Our assessment is therefore that the traffic impact of the proposed toll increases on the road system linking Shatin and Kowloon is unlikely to be significant.

(C) *Public Affordability and Acceptability*

11. In this respect, both the Transport Panel of the Legislative Council and TAC have expressed concern. In its advice to the Government, TAC has stated that its members are concerned about the public sentiment on the proposed toll increases. The view is taken that as the last toll increases were implemented in November 2008, another imminent round of increases within a relatively short interval would impact on road users and add to their costs of transportation at a time when a stable economic recovery of Hong Kong is still far from certain. It would also give rise to a public perception of lax regulation and convey a misleading message that the public transport services and facilities operators may seek to increase the pricing of their services to the public as frequently as they see fit on commercial grounds.

(D) *Arbitration*

12. Under the Ordinance, if an agreement on the toll increases cannot be reached between the Government and TCTC, either party may resort to arbitration under the Arbitration Ordinance (Chapter 341). Therefore TCTC has the right to resort to arbitration if its application for the toll increases is rejected by the Chief Executive-in-Council. In this context we note that for previous arbitrations in the case of the Eastern Harbour Crossing (EHC), which has a similar toll adjustment and arbitration mechanism, the awards were in favour of the EHC franchisee, allowing it to raise its tolls substantively so as to achieve an IRR of 15-17% over the life of the franchise.

⁵ The average daily throughputs of LRT and Tate's Cairn Tunnel in February 2010 were 87,206 and 52,538 respectively, which were 1.4% and 6.5% lower than their respective throughputs in February 2008 (before the commissioning of Route 8), indicating the diversion effect of Route 8. The overall daily throughput of all tolled tunnels/bridge increased by 5.0% over the same period.

Besides, any arbitration proceedings will mean cost implications to the Government.

Timing of Implementation

13. In its advice to the Government, TAC has asked the Chief Executive-in-Council to take into account from a wider social perspective the concerns of TAC about public sentiment as set out in paragraph 11 above. In considering the implementation of the toll increase application, the Chief Executive-in-Council has taken into account the above concerns and decided that the toll increases should take effect on 25 December 2010, i.e. more than two years since the last increases.

IMPLICATIONS OF THE PROPOSAL

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

PUBLIC CONSULTATION

15. TCTC's original application was discussed at the Legislative Council Panel on Transport's meeting on 15 December 2009. Some Panel Members expressed objection to the toll increases. Their main concern was that the last toll increases were only effected in November 2008 and that the current application might trigger a round of fee increases by other public utilities. Some Members requested TCTC not to increase the tolls for certain public transport vehicles. After the Panel meeting, the Administration continued to urge TCTC to consider its toll increases proposal in the light of public acceptability, and TCTC agreed in January 2010 to revise its application as mentioned in paragraph 4 above.

16. The TAC was consulted on TCTC's application in February 2010. TAC took into account all relevant factors⁶ and concluded that in narrow financial and investment terms the proposed toll increases per se are not unreasonable and are justified. However, TAC also pointed out that another imminent round of toll increases within a relatively short interval would impact on road users and add to their costs of transportation at a time when a

⁶ Including financial position of TCTC, return on investment, traffic impact of the proposed toll increase and public acceptability.

stable economic recovery is not certain. It suggested that the Chief Executive-in-Council may, from a wider social perspective, wish to take into account the concerns of TAC about public sentiment on the timing of implementing the proposed toll increases. TAC's detailed advice is set out in its letter to the Secretary for Transport and Housing at **Annex C**.

PUBLICITY

17. A press release was issued on 19 May 2010 on the decision of the Chief Executive-in-Council.

ENQUIRIES

18. Any enquiries concerning this Brief can be directed to Miss Erica Ng, Principal Assistant Secretary for Transport and Housing, at 2189 2182.

Transport and Housing Bureau
May 2010

LEGISLATIVE COUNCIL BRIEF

Tate's Cairn Tunnel Ordinance
(Chapter 393)

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

List of Annexes

- Annex A — Section 36 of the Tate's Cairn Tunnel Ordinance
(Cap. 393)

- Annex B — Implications of TCTC's Proposed Toll Increase

- Annex C — TAC's Advice

Annex A

Chapter: 393	Title: TATE'S CAIRN TUNNEL ORDINANCE	Gazette Number:
Section: 36	Heading: Company to charge approved tolls for use of tunnel	Version Date: 30/06/1997

PART VIII

COLLECTION OF TOLLS

- (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.

(Enacted 1988)

Implications of TCTC's Proposed Toll Increase

Financial Implications

1. If TCTC's proposed toll increase is approved by Chief Executive-in-Council, the estimated royalty revenue to be paid to the Government in 2011/12 will be increased by \$0.56 million to \$18.19 million.

Economic Implications

2. Given that tolls for using the Tate's Cairn Tunnel constitute an insignificant proportion of average household spending, TCTC's proposed toll increase would have a minimal lifting effect on the Consumer Price Index.



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19 March 2010

Ms Eva Cheng, JP
Secretary for Transport and Housing
16/F, Murray Building
Garden Road
Hong Kong

Dear Ms Cheng,

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

The Transport Advisory Committee (TAC) has examined in detail the toll increase application submitted by the Tate's Cairn Tunnel Company Limited (TCTC) at its meetings on 5 February and 2 March 2010. This letter sets out TAC's views on the application and its advice to the Chief Executive-in-Council.

TCTC applied to the Administration in July 2009 for a \$1 toll increase for each vehicle category using the Tate's Cairn Tunnel. Having regard to the views expressed by the Transport Panel of the Legislative Council and further communication with the Administration, TCTC submitted a revised application in January this year: instead of a \$1 toll increase across the board, it now proposes not to increase the toll for public light buses and to provide \$1 promotional discount for empty taxis between midnight and 6 a.m. The revised toll increases range from 0% to 9% for different vehicle types.

TAC took all relevant factors and circumstances into account in considering the revised application, including the financial position of TCTC, return on investment, traffic implications that might be brought about by the proposed toll increase, the prevailing economic conditions and public acceptability. Its findings and views are summarized below.

Members noted the improvement in the financial performance of TCTC. Its bank loan and shareholders' loan have been repaid. It has wiped off the accumulated losses over the years with an accumulated profit of \$103 million at the end of 2007/08. However, compared with the Eastern Harbour Crossing, a similar infrastructure project, which was commissioned around the same time, TCTC's financial position was substantially less favourable. TCTC attributed this situation largely to a lower than forecast traffic volume over the years as a result of a number of factors, including increasing toll disparity between Lion Rock Tunnel and Tate's Cairn Tunnel, relocation of the airport, economic difficulties between 1998/99 and 2003/04, a wider choice of transport modes and alternative route choices, as well as migration of manufacturing activities to the Mainland. Against this background, TCTC would achieve an Internal Return of Investment (IRR) of 6.0% over the 30-year franchise period based on the current forecast.

If the toll increase application was approved, this would increase the IRR to 6.1%. In this context, Members noted that in its franchise bid submitted in 1988, TCTC had made an assumption that the project, with a construction cost of about \$1,962 million, would generate an IRR of 13.02% over the 30-year franchise period. Members consider that for such a large scale and long term infrastructure investment, an IRR of 6.1% under the current toll increase application would not be unreasonable or excessive.

From a traffic management perspective, Members noted that with the proposed toll increase, about 500 vehicles would be diverted to the Lion Rock Tunnel and 100 to each of Tai Po Road and Route 8 (between Cheung Sha Wan and Shatin) each day. The traffic impact 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.

Members are however concerned about the public sentiment on the proposed toll increases. They noted that the last toll increases were implemented in November 2008. Another imminent round of increases within a relatively short interval would impact on road users and add to their costs of transportation at a time when a stable economic recovery of Hong Kong is still far from certain. It would also give rise to a public perception of lax regulation and convey a misleading message that the public transport services and facilities operators may seek to increase the pricing of their services to the public as frequently as they see fit on commercial grounds.

In conclusion, TAC is of the view that in narrow financial and investment terms the proposed toll increases per se are not unreasonable and are justified but the Chief Executive-in-Council may, from a wider social perspective, wish to take into account the concerns of TAC as set out in the preceding paragraph when he considers the application. Members were aware of the right of TCTC to resort to arbitration in the event of disagreement between it and the Chief Executive-in-Council. It would be desirable where possible for the two parties to reach an agreement on the toll increases than to incur public expenditure by way of legal costs in resolving any differences. I should be grateful if you would convey TAC's advice to the Chief Executive-in-Council.

Yours sincerely,



(Ms Teresa Cheng)
Chairman
Transport Advisory Committee