

For discussion
14 December 2012

LEGISLATIVE COUNCIL PANEL ON TRANSPORT

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

PURPOSE

Tate's Cairn Tunnel Company Limited (TCTC) has applied for an increase in tolls. This paper seeks Members' views on the application.

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 (TCT) for 30 years starting from July 1988, inclusive of the construction period. The tunnel was opened to traffic in June 1991. TCTC's franchise 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 the tunnel company. 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 arbitrators shall be guided by the need to ensure that the company is reasonably but not excessively remunerated for carrying out its obligations, or exercising its rights under the Ordinance.

TCTC's APPLICATION FOR TOLL INCREASE

4. So far, TCTC has had six toll increases which came into effect in May 1995, November 1996, January 2000, August 2005, November 2008 and December 2010 respectively.

5. TCTC submitted on 26 March 2012 an application for a toll increase at TCT of \$3 for private car, and proportionate increases for other vehicle types (the proposed increase ranges from \$2 for motorcycle to \$6 for double-decker bus), with effect from 1 July 2013. The magnitude of toll increase for different vehicle types ranges from 17% to 24%, and the weighted average rate of toll increase is 19.6%¹. The toll increase would enable the company to achieve an Internal Rate of Return on equity after tax (IRR) of 6.87% over the 30-year franchise period.

6. Upon receipt of TCTC's toll increase application, we have urged the company to reconsider the need for any toll increase and whether the proposed magnitude of increase is excessive. We tried to persuade the company to reduce the magnitude of the toll increase being applied for and minimise the impact of the toll increase on public transport services. TCTC subsequently agreed to reduce the magnitude of toll increase and submitted a revised toll increase application on 8 November 2012 as follows –

- (i) \$2 increase for all types of vehicles and additional axle except for motorcycle; and
- (ii) \$1 increase for motorcycle.

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.

7. The existing tolls and new tolls proposed by TCTC are as follows –

	Motor-cycle	Private car & taxi	Public light bus	Private light bus & light goods vehicle	Medium & heavy goods vehicle	Single-decker bus	Double-decker bus	Extra axle
Existing Tolls	\$12	\$15	\$21	\$22	\$26	\$29	\$32	\$19
<i>Original Proposed Tolls</i>	<i>\$14</i>	<i>\$18</i>	<i>\$26</i>	<i>\$26</i>	<i>\$31</i>	<i>\$35</i>	<i>\$38</i>	<i>\$23</i>
<i>Increase % (Increase magnitude)</i>	<i>17% (\$2)</i>	<i>20% (\$3)</i>	<i>24% (\$5)</i>	<i>18% (\$4)</i>	<i>19% (\$5)</i>	<i>21% (\$6)</i>	<i>19% (\$6)</i>	<i>21% (\$4)</i>
Revised Proposed Tolls	\$13	\$17	\$23	\$24	\$28	\$31	\$34	\$21
<i>Increase % (Increase magnitude)</i>	<i>8% (\$1)</i>	<i>13% (\$2)</i>	<i>10% (\$2)</i>	<i>9% (\$2)</i>	<i>8% (\$2)</i>	<i>7% (\$2)</i>	<i>6% (\$2)</i>	<i>11% (\$2)</i>

TCTC's Financial Performance

8. By the end of June 2011, TCTC had accumulated profit of \$625 million, representing a shortfall of \$3,442 million as compared with the expected cumulative profit of \$4,067 million in the company's base case projection when bidding for the franchise. The difference between the actual profit/loss of TCTC and base case projections over the years is set out below –

Profit & Loss (in \$million)			
Year²	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)
Cumulative	4,067	625	(3,442)

² TCTC's financial year is from 1 July to 30 June of the following year.

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

9. TCTC started to make 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 \$625 million at the end of 2010/11. The company started to pay dividends in 2008/09.

10. TCTC attributes the lower-than-expected toll revenue to the following –

- (a) increasing toll disparity between the Lion Rock Tunnel (LRT) and TCT (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;
- (c) diversion effect due to an increase in transportation modes and road choices, for instance, the opening of Route 3 (Tai Lam Tunnel), Ma On Shan Railway and Route 8; and
- (d) migration of industrial/manufacturing activities to the Mainland.

The Administration's Assessment

(I) Guiding Principle – Reasonable but not Excessive Remuneration

11. On the basis of the Base Toll Proposal which accompanied its franchise bid, the company expected that it would achieve an IRR of 13.02% over the 30-year franchise period. In considering TCTC's franchise bid in 1988, the Government agreed to the initial tolls but gave no undertaking in respect of subsequent toll adjustments. Neither was there any agreement on a guaranteed rate of return.

12. TCTC's target IRR was the lowest among the four Build-Operate-Transfer tunnels in Hong Kong. Route 3 (Country Park Section) had a target IRR of 15.18%, while the targets for the Eastern Harbour Crossing and the Western Harbour Crossing were both 16.5%. TCTC projects that it will be able to achieve an IRR of 6.76% over the 30-year franchise period should the revised toll increase application be approved. If no toll increase is to be made before the end of the franchise, TCTC will only achieve an IRR of 6.61%.

(II) Traffic Assessment

13. Currently, TCT has an average daily throughput of 53 100 vehicles⁴, against its design capacity of 78 500 vehicles. TCTC has estimated that with its proposed toll increase, about 500 vehicles will be diverted to LRT and less than 100 vehicles would be diverted to Tai Po Road and Route 8 between Cheung Sha Wan and Shatin respectively per day.

(III) Public Affordability and Acceptability

14. Under TCTC's revised toll increase proposal (i.e. \$2 increase for all types of vehicles and additional axle except for motorcycle; and \$1 increase for motorcycle), the percentage of increase ranges from 6% for double-decker bus to 13% for private car, with a weighted average rate of toll increase of 11.1%. It would enable the company to achieve an IRR of 6.76% (as compared with 6.87% in its original proposal). While we have reminded TCTC of the importance of having due regard to public affordability and acceptability in devising their tolling strategy, we note that the weighted average rate of TCTC's current toll increase of 11.1% is lower than the cumulative change in the Composite Consumer Price Index since the last toll increase from 25 December 2010 up to end June 2013 (proposed date for the toll increase in their application is 1 July 2013), which is estimated to be 11.3%.

⁴ Based on 2011 traffic statistics.

(IV) Arbitration

15. As mentioned in paragraph 3 above, if an agreement on the toll increase cannot be reached between the Government and TCTC, either party may resort to arbitration under the Arbitration Ordinance. Therefore, TCTC has the right to resort to arbitration if its application for the toll increase is rejected by the Chief Executive in Council. So far, the Government and TCTC have been able to reach agreement on all previous six toll increase applications, and arbitration was never resorted to.

ADVICE SOUGHT

16. Members' views are invited on the toll increase application submitted by TCTC.

**Transport and Housing Bureau
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