

**For discussion**  
**17 April 2015**

## **LEGISLATIVE COUNCIL PANEL ON TRANSPORT**

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

#### **Purpose**

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

#### **Background**

2. TCTCL 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. TCTCL'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 ("CE-in-C") 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.

## **TCTCL's Application for Toll Increase**

4. So far, TCTCL had seven toll increases which came into effect on 1 May 1995, 1 November 1996, 2 January 2000, 1 August 2005, 30 November 2008, 25 December 2010 and 1 August 2013 respectively. In all previous seven toll increase applications, the Government and the TCTCL have been able to reach agreement without resorting to arbitration.

5. TCTCL submitted on 23 September 2014 an application for the eighth toll increase at TCT to take effect on 1 August 2015 as follows –

- (a) \$3 increase for all types of vehicles and additional axle in excess of two (“additional axle”), except for motorcycles; and
- (b) \$2 increase for motorcycles.

The magnitude of toll increase for different vehicle types ranges from 9% to 18%, and the weighted average rate of toll increase is 15%<sup>1</sup>. The toll increase will enable the company to achieve an Internal Rate of Return on equity after tax (“IRR”) of 6.91% over the 30-year franchise period.

6. Upon receipt of TCTCL's toll increase application, we have urged the company to reconsider the need for the toll increase and whether the proposed magnitude of increase is appropriate. We persuaded the company to reduce the magnitude of the toll increase application, in particular minimising the impact of the toll increase on public transport vehicles (namely public light buses and buses) as well as goods vehicles. TCTCL subsequently revised its original proposal on 26 March 2015 and agreed to reduce the magnitude of toll increase as follows –

- (a) no increase for public light buses, and all types of goods vehicles;
- (b) \$1 increase for single-decker and double-decker buses;

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<sup>1</sup> 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.

- (c) \$2 increase for motorcycles, and private light buses; and
- (d) \$3 increase for private cars, taxis and every additional axle.

Under the revised toll increase proposal, the percentage of increase ranges from no increase for public light buses and goods vehicles to 18% for private cars and taxis, with a weighted average rate of toll increase of 11.9%.

7. TCTCL has also deferred the effective date of the above toll increase to 1 December 2015. Further, TCTCL has undertaken not to apply for any more toll increase during the franchise period.

8. The existing tolls and new tolls proposed by TCTCL are as follows –

	<b>Motor-cycles</b>	<b>Private cars &amp; taxis</b>	<b>Private light buses</b>	<b>Public light buses</b>	<b>Light goods vehicles</b>	<b>Medium &amp; heavy goods vehicles</b>	<b>Single-decker buses</b>	<b>Double-decker buses</b>	<b>Additional axle</b>
<b>Existing Tolls</b>	<b>\$13</b>	<b>\$17</b>	<b>\$24</b>	<b>\$23</b>	<b>\$24</b>	<b>\$28</b>	<b>\$31</b>	<b>\$34</b>	<b>\$21</b>
<b>Original Proposed Tolls</b>	<b>\$15</b>	<b>\$20</b>	<b>\$27</b>	<b>\$26</b>	<b>\$27</b>	<b>\$31</b>	<b>\$34</b>	<b>\$37</b>	<b>\$24</b>
<i>Increase % (Increase magnitude)</i>	<i>15% (\$2)</i>	<i>18% (\$3)</i>	<i>13% (\$3)</i>	<i>13% (\$3)</i>	<i>13% (\$3)</i>	<i>11% (\$3)</i>	<i>10% (\$3)</i>	<i>9% (\$3)</i>	<i>14% (\$3)</i>
<b>Revised Proposed Tolls</b>	<b>\$15</b>	<b>\$20</b>	<b>\$26</b>	<b>\$23</b>	<b>\$24</b>	<b>\$28</b>	<b>\$32</b>	<b>\$35</b>	<b>\$24</b>
<i>Increase % (Increase magnitude)</i>	<i>15% (\$2)</i>	<i>18% (\$3)</i>	<i>8% (\$2)</i>	<i>0% (-)</i>	<i>0% (-)</i>	<i>0% (-)</i>	<i>3% (\$1)</i>	<i>3% (\$1)</i>	<i>14% (\$3)</i>

9. The last toll increase at TCT was effected on 1 August 2013, with a \$2 increase for all types of vehicles and additional axle (except for motorcycles), and \$1 increase for motorcycles. The then weighted average rate of toll increase was 11.1%.

### **TCTCL's Financial Performance**

10. By the end of June 2014, TCTCL had accumulated profit of \$1,283 million, representing a shortfall of \$4,057 million as compared with the expected cumulative profit of \$5,340 million in the company's base case projection when bidding for the franchise. The difference between the actual profit/loss of TCTCL and base case projections over the years is set out below –

<b>Profit &amp; Loss (in \$million)</b>			
<b>Year<sup>2</sup></b>	<b>Base Case Projection (A)</b>	<b>Actual Profit/Loss (B)</b>	<b>Difference (B-A)</b>
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 <sup>3</sup>	-	120	120

<sup>2</sup> TCTCL's financial year is from 1 July to 30 June of the following year.

<sup>3</sup> The deferred tax adjustment was a result of the adoption of a revised accounting standard.

<b>Profit &amp; Loss (in \$million)</b>			
<b>Year<sup>2</sup></b>	<b>Base Case Projection (A)</b>	<b>Actual Profit/Loss (B)</b>	<b>Difference (B-A)</b>
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)
2011/12	427	208	(219)
2012/13	425	212	(213)
2013/14	421	238	(183)
<b>Cumulative</b>	<b>5,340</b>	<b>1,283</b>	<b>(4,057)</b>

11. TCTCL started making 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 \$1,283 million at the end of 2013/14. The company started to pay dividends in 2008/09.

12. TCTCL attributes the lower-than-expected toll revenue to the following –

- (a) increasing toll disparity between the Lion Rock Tunnel (“LRT”) and TCT (according to TCTCL, 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 that of TCT’s. This scenario has not materialised.);
- (b) diversion effect due to an increase in transportation modes and road choices; and

- (c) migration of industrial/manufacturing activities to the Mainland.

### **The Government's Assessment**

*(I) Guiding Principle – Ensuring a Reasonable but not Excessive Remuneration to TCTCL*

13. While the Ordinance has not set out the criteria for determining toll adjustments, it stipulates that if the CE-in-C and the tunnel franchisee cannot agree on a toll variation, the matter can be submitted for arbitration. The Ordinance stipulates that the arbitrators shall be guided by the need to ensure that the tunnel company is reasonably but not excessively remunerated, having regard to, inter alia, any material change in the economic conditions since tolls were last determined. In considering previous toll increase applications from TCTCL, the IRR is considered an indicator to determine whether the tunnel franchisee was reasonably but not excessively remunerated.

14. On the basis of the Base Toll Proposal which accompanied its franchise bid submitted in 1988, TCTCL expected that it would achieve an IRR of 13.02% over the 30-year franchise period. In considering TCTCL's franchise bid in 1988, the Government agreed to the initial tolls but gave no undertaking in respect of subsequent toll adjustments. Nor was there any agreement on a guaranteed rate of return.

15. TCTCL'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%. TCTCL projects that it will be able to achieve an IRR of 6.91% over the 30-year franchise period should the revised toll increase application be approved. If no toll increase were made before the end of the franchise, TCTCL would only achieve an IRR of 6.81%.

## *(II) Traffic Assessment*

16. In 2014, TCT had an average daily throughput of 57 000 vehicles, against its design capacity of 78 500 vehicles. TCTCL has estimated that with its proposed toll increase, about 700 vehicles per day will be diverted to LRT (which runs largely parallel to TCT), about 100 vehicles per day would be diverted to Tai Po Road and about 300 vehicles per day would be diverted to Route 8 between Cheung Sha Wan and Shatin respectively.

## *(III) Public Affordability and Acceptability*

17. In assessing public acceptability and affordability, the weighted average rate of toll increase is compared to the cumulative change in the Composite Consumer Price Index (“CCPI”) since the last toll increase up to TCTCL’s proposed effective date of the toll increase (i.e. 1 December 2015).

18. We have reminded TCTCL of the importance of paying due regard to public affordability and acceptability in devising their tolling strategy. We note that under TCTCL’s revised toll application, the weighted average rate of increase is 11.9%. This is lower than the cumulative change in CCPI since the last toll increase from 1 August 2013 up to end November 2015, which is estimated to be 12.4%<sup>4</sup>.

## *(IV) Arbitration*

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

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<sup>4</sup> The figure is estimated on the basis of the latest CCPI of February 2015 released by Census and Statistics Department and the Government’s forecast of the increase of 3.5% in CCPI for 2015 as announced in the 2015/16 Budget .

## **Advice Sought**

20. Members' views are invited on the toll increase application submitted by TCTCL.

**Transport and Housing Bureau**  
**April 2015**