

Toll increase at Eastern Harbour Crossing rejected

The Chief Executive in Council (CE in Council) rejected today (June 21) an application from the New Hong Kong Tunnel Company Limited (NHKTC) for a toll increase at the Eastern Harbour Crossing (EHC).

"In assessing the toll increase application at EHC, the Government noted the strong financial position of NHKTC, and that the level of NHKTC's internal rate of return (IRR) is at a high level. Taking all relevant factors into consideration, the Government considered that there are insufficient justifications from NHKTC to support the present toll increase application," a spokesman for the Transport and Housing Bureau said.

"In light of the views received during consultation with the Legislative Council Panel on Transport and the Transport Advisory Committee, the Government is very concerned about public affordability and acceptability of NHKTC's proposed toll increase at the EHC having regard to the strong financial position of the company", the spokesman said.

NHKTC submitted an application to increase the tolls for private cars and taxis by \$10 (or 40 per cent) with proportionate increases for other categories of vehicles.

NHKTC's main argument is that when its first toll increase was rejected in October 1995 and the company went for arbitration, the arbitrator in April 1997 ruled that a reasonable but not excessive remuneration to NHKTC fell within a range of 15 per cent to 17 per cent IRR. According to NHKTC, even after the current proposed toll increase, the IRR likely to be achieved over the life of its franchise would be 14.51 per cent which still falls short of the lower range of a "reasonable return" of 15 per cent as ruled by the arbitrator in 1997.

"NHKTC has consistently enjoyed a healthy financial position with all bank loans fully repaid in July 2001. The company's cumulative profit up to the end of 2010 stood at \$5,125 million. NHKTC started paying dividends from 1994 onwards and total dividends paid up to the end of 2010 amounted to \$5,091 million. The existing estimated IRR of NHKTC at 14.26 per cent (with no toll increase) compares favourably with other Build-Operate-Transfer tunnels in Hong Kong," the spokesman said.

In considering NHKTC's franchise bid in 1986, the Government did not give any undertaking in respect of any subsequent toll increase nor the level of IRR.

"From the traffic management point of view, the actual average daily traffic throughput of the EHC in 2009 and 2010 were 63,000 and 67,500 respectively against its design capacity of 78,500 vehicles per day. No undue congestion is observed at its approach roads. There is hence also no justification on traffic management grounds to support the proposed toll increase," the spokesman added.

"We have urged the company to reconsider the need and timing for any toll increase and to have due regard to public affordability and acceptability in devising their toll strategy."

"Despite our persuasion, NHKTC maintained that the application be submitted to the CE in Council for consideration as soon as possible."

If the toll increase application is rejected, according to the EHC Ordinance, NHKTC may resort to arbitration. If NHKTC again resorts to arbitration, the arbitration rulings in 1997 and 2005 regarding the level of a "reasonable but not excessive remuneration" are not binding on subsequent cases. Each case has to be considered on its own merit.

The Legislative Council Panel on Transport and the Transport Advisory Committee (TAC) were consulted on NHKTC's application on February 25, 2011, and March 28, 2011, respectively. Both raised strong objections to the proposed toll increase. The TAC's detailed advice to the CE in Council is attached in the Annex.

Annex

May 4, 2011

The Honourable Eva Cheng, JP
Secretary for Transport and Housing
16/F, Murray Building
Garden Road

Central
Hong Kong

Dear Ms Cheng,

The New Hong Kong Tunnel Company Limited's Application for Toll Increase

The Transport Advisory Committee (TAC) has examined the toll increase application submitted by the New Hong Kong Tunnel Company Limited (NHKTC) at its meeting on March 28, 2011. This letter sets out TAC's view on the application and its advice to the Chief Executive-in-Council.

NHKTC submitted on August 23, 2010 an application for a \$10 or 40% toll increase for private cars and taxis with proportionate increases for other categories of vehicles using the Eastern Harbour Crossing (EHC).

In considering NHKTC's application, the TAC took all relevant factors into account including:

- (a) the financial position of NHKTC;
- (b) NHKTC's return on investment;
- (c) traffic condition at EHC;
- (d) economic condition of Hong Kong; and
- (e) public affordability and acceptability.

Members noted that NHKTC had consistently achieved a healthy financial position. It started to make an operating profit in 1992, i.e. about three years after the commissioning of the EHC and also wiped off the accumulated loss by end 1993. By end of December 2009, NHKTC had accumulated a profit of about \$4,688 million. NHKTC has fully repaid its bank loans in July 2001 and started to pay dividends from 1994 onwards. Total dividends paid up to the end of 2009 amounted to \$4,658 million. Members were of the view that the financial position of NHKTC was at a very satisfactory level.

Members noted that NHKTC's justification for a toll increase was mainly premised upon what constituted a "reasonable but not excessive remuneration" to NHKTC as determined in the 1997 arbitration, which was an Internal Rate of Return (IRR) between 15% and 17% over the 30-year franchise. In the 2005 arbitration, the arbitrators had ruled that the level of "reasonable but not excessive remuneration" remained an IRR of between 15% and 17%. NHKTC explained that over the past few years, the Company had been operating at below the lower end of its expected IRR and without a toll increase, the IRR over the life of the franchise was estimated to be 14.26% which was less than the lower range of a "reasonable but not excessive remuneration" of 15%. Even with the current proposed toll increase, the IRR likely to be achieved over the life of the franchise was estimated at 14.51%, which still fell short of the lower range of a "reasonable but not excessive remuneration".

Members noted that the previous arbitration rulings in 1997 and 2005 were not binding and each application for toll revision should be considered on its own merits and against the prevailing relevant circumstances. Members unanimously agreed that given the economic and social changes after the commencement of the franchise, it would be unrealistic for NHKTC to expect that the definition of a reasonable return made at a time when the economy in Hong Kong was thriving should continue to apply without reference to the changes in the economic environment since then. Members also noted that the estimated IRR of NHKTC at 14.26% even without a toll increase already compared favourably with other "Building-Operate-Transfer" tunnels currently in operation in Hong Kong, and that an IRR of 14.26% appeared to be more than a reasonable return under the current economic conditions.

From a traffic management point of view, Members noted that the average daily traffic throughput at EHC in 2009 and 2010 were 63,000 and 67,500, against its design capacity of 78,500 vehicles per day. Members also noted that even without the proposed toll increase, the traffic flow estimated at EHC as estimated by NHKTC from 2011 to the end of its franchise period in 2016 was unlikely to exceed the design capacity. There is hence no justification on traffic management grounds for any toll increase.

According to NHKTC's estimate, the traffic flow at EHC would decrease by about 13% in 2011 if the proposed toll increase of 40% were approved. Members envisaged that as a result of the proposed toll increase, some of the users of EHC might switch to using the Cross Harbour Tunnel (CHT), which might aggravate the

congestion at CHT. Members believed that such traffic implication should be taken into account in considering the application.

Members also expressed serious reservation over public acceptability and affordability of the proposed toll increase at the EHC. Members expected that the public would strongly oppose the proposed significant toll increase of 40%, especially having regard to both the strong financial position of NHKTC and the present economic climate (including the issue of inflation).

Taking into account all relevant factors, the TAC is firmly of the view that NHKTC's present toll increase application should be rejected. I should be grateful if you would convey TAC's advice to the Chief Executive-in-Council. The TAC's advice as contained in this letter may be released for public information after the Chief Executive-in-Council's decision is announced.

Yours sincerely,

[signed]

(Rimsky Yuen, S.C.)
Chairman
Transport Advisory Committee

Ends/Tuesday, June 21, 2011

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