

For Information
on 19 December 2000

**LegCo Panel on Economic Services
Tariff of The Hongkong Electric Company Limited (HEC)**

At the meeting on 27 November 2000, Members asked to be provided with information on the implications of HEC's tariff components adjustment for 2000; implications of its investment plans on tariff; and detailed information relating to HEC's tariff for 2001.

2. We have referred Members' request to HEC and its response is set out in the Annex.

3. We would also like to add that the Administration agrees to adjustment of HEC's tariff components for 2000 because with such a change, HEC's customers would not need to pay more tariff in 2000. At the same time, HEC's shareholders would not earn more than the permitted return under the Scheme of Control Agreement.

4. Members may wish to note the reason given by HEC as to why it could only provide information relating to its tariff for 2001 at the meeting on 19 December 2000.

Economic Services Bureau
December 2000

***LegCo Panel on Economic Services
Tariff of The Hongkong Electric Company, Limited***

In September this year, The Hongkong Electric Company, Limited (“HEC”) announced to their customers that there has been some adjustments to the individual tariff components for 2000. This consists of an increase in basic tariff of 6.3 cents per unit, a reduction of 0.4 cents per unit for the rate reduction rebate, and an increase in the Fuel Clause Rebate of 6.7 cents per unit. These adjustments, however, did not result in any changes in the tariff payable by customers.

REASON FOR THE CHANGE IN TARIFF COMPONENTS

2. When conducting the tariff review last year for Year 2000, it became obvious that taking into account the fact that tariff had been frozen since 1998, there was great pressure for an increase in tariff in order to meet operating cost and achieve the permitted return. Whilst under the Scheme of Control (“SOC”), HEC could have increased tariff in January 2000, the company also noted that the economy was still recovering and any increase in electricity charges would add to the burden of the community. Since the Development Fund Balance was low (there had been no excessive built-up of the Development Fund over the past years), the company, with the approval of the Government, implemented the above-mentioned change in the components of the tariff so that the tariff payable by customers can remain unchanged for 2000. This is not something designed to earn more profit than is permitted under the SOC. In fact, if this step had not been taken, an increase in the tariff payable by customers would have been required.

3. Whilst we have tried to do what we could so that customers would not need to face an increase in tariff payable by them in 2000, as a publicly listed company, the interests of our shareholders, which include many members of the public, must not be neglected either. The fact of the matter is that under the SOC Agreement, HEC can seek to earn its permitted return if the company fulfils its obligations, although the permitted return is not guaranteed in that the actual return could be lower if the business in a particular year did not meet forecast and the balance in the Development Fund is insufficient to meet the shortfall. The embodiment of the permitted return in the SOC has been most important to HEC because our shareholders, both local and international, have been investing in Hongkong Electric Holdings Limited (“HEH” – the parent company of HEC) shares because of its stable earnings.

4. Furthermore, the SOC has enabled HEC to secure very low interest rate borrowing from banks and suppliers' credits. If we fail to make the permitted return, our credit rating might be affected and it could be more costly to borrow. For example, assuming a loan of \$10 billion, an increase of 30 to 50 basis points in lending rates would result in an increase in financing cost of \$30 million to \$50 million, which will have an impact on tariff payable by customers.

EFFECT OF THE CHANGE IN TARIFF COMPONENTS

5. HEC wishes to emphasize that the company does not and will not earn more profit than is permitted under the SOC through the change of tariff components in 2000. The change enables HEC to freeze tariff payable by customers in 2000 at 1998 level.

IMPLICATIONS

6. Concern has been expressed about the implications of this change in tariff components. We must point out that ever since the Fuel Clause Recovery Account was introduced in 1986, it has fluctuated between credit and debit balances. The objective of the Account is to pass through the variation of the fuel costs between standard and actual back to customers. Another objective is to stabilise tariff and this has always been stated in the Annual Report. In fact, the actual tariff levels payable by customers would only be determined following the Tariff Reviews at the end of the preceding year taking into account the latest position in respect of sales, investment requirement, environmental measures, movements in fuel costs, contractor charges, material and plants, etc. HEC has a proven track record of charging the minimum possible tariff consistent with the provisions of the SOC, and this will continue.

HEC'S TARIFF ADJUSTMENT IN 2001

7. The Economic Services Bureau has conveyed the request from Honourable Members for information relating to the tariff in 2001. Since HEC is a listed company, it has to follow the Listing Rules (see attached) in disclosing market sensitive information in order to avoid unfair trading of its shares. Therefore, whilst HEC would be happy to brief Members of the Panel on Economic Services, information on the tariff for 2001 cannot be disclosed in advance. We would explain our tariff to Members at the meeting on 19th December 2000.

HEC'S COMMITMENT TO ITS CUSTOMERS

8. In the long history of HEC, we have always provided an adequate and reliable supply of electricity to our customers, at tariff rates which, overall speaking, are much below inflation. We only make timely and justified investments necessary to ensure demands are met. This policy will continue, and with a number of recently introduced safeguards agreed with Government to guard against over-capacity, the interests of customers are further protected. As for the impact on the 2001 tariff due to the new power station to be built at the Lamma Extension, since the expenditure would have just started to be incurred, there is very little impact on the tariff in 2001.

The Hongkong Electric Co Ltd
December 2000

A recent Announcement by The Stock Exchange of Hong Kong :-

“ One of the aims of the Exchange Listing Rules is to encourage the even dissemination of information to all shareholders and investors and not to selected individuals. Thus the Exchange Listing Rules prescribe minimum standards for the dissemination of information about listed issuers. ”

The Listing Rules referred to in this announcement include the following statements :-

“ When developments are on hand which are likely to have a significant effect on market activity in or the price of any listed securities, it is the direct responsibility of the directors to ensure that such information is kept strictly confidential. ”

and

“ The question of timing of the release of an announcement to the market is crucial, having regard to its possible effect on the market price of the Issuer's listed securities. The overriding principle is that information which is expected to be price-sensitive should be announced immediately it is the subject of a decision. Failure to follow this principle may result in the Exchange imposing a temporary suspension of dealings. ”