

Translation

Fax No. : 2537 1002

Tel. No. : 2810 2538

25 July 2005

By fax (fax no.: 2121 0420)

Mr Andy Lau
Clerk to Panel
LegCo Panel on Economic Services
Legislative Council
Citibank Tower
3 Garden Tower, Hong Kong

Dear Mr Lau,

**Panel on Economic Services
Financial Plans of the Two Power Companies**

Please find at Annex the information requested by Hon Fred Li on 22 July 2005.

Yours sincerely,

(Ms Brenda Cheng)
for Secretary for Economic Development and Labour

c.c. Secretariat of Legislative Councillors of the Democratic Party
(Attn : Hon Fred Li) – 2537 2560

- Q1. Provide forecasts of Hong Kong's overall electricity consumption and reserve margins in 2005-2008.
- A1. Overall electricity consumption is projected to grow by about 3% per annum in the medium term. Both power companies estimate their reserve margins by 2008 to be lower than that in 2004. The reserve margin of HEC in 2004 was 32% while that for CLP was 31%.
- Q2. Provide details of the capital expenditure in the two power companies' Financial Plans.
- A2. For the purpose of ensuring sufficient, safe and reliable electricity supply in Hong Kong and meeting the environmental requirements, the Government has accepted the capital expenditure of the two power companies in the Financial Plans.
- Capital expenditure in CLP's 2005 Financial Plan is around \$24 billion, about two-thirds of which will be for expanding and upgrading of the Company's transmission and distribution networks for the purposes of meeting demand growth, and enhancing supply quality and reliability. The rest is for maintenance and refurbishment of generating facilities, installation of emission reduction facilities, and enhancement of customer service facilities.
 - Capital expenditure in HEC's 2004-2008 Financial Plan is around \$12 billion, about half of which will be for transmission and distribution network, while the rest is for generation facilities and new projects for minimizing environmental impact.
- Q3. In their Financial Plans, HEC will commission L9 in 2006 and CLP will commission Black Point Units 7 and 8 in 2005 and 2006 respectively. Would the commissioning of these new generating units lead to tariff increase? If yes, could their commissioning be deferred?
- A3. HEC's latest maximum demand forecasts confirm that the unit L9 will be required in 2006 to ensure supply reliability.

With regard to Units 7 and 8 at Black Point, we informed the Legislative Council Panel on Economic Services in December 1999 that, in the interest of the consumers and after considering various options, Government had agreed to the most economical option proposed by CLP to defer installation of Unit 7 from 2003 to 2005 and Unit 8 from 2004 to 2006. Installation works on Units 7 and 8 have therefore been largely completed in the previous Financial Plan period. With the commissioning of Units 7 and 8, the installed generating capacity of CLP will be sufficient to meet the expected electricity demand in the Company's supply area throughout the Financial Plan period.

The tariff to be applied is determined every year in accordance with the provisions of the Scheme of Control Agreement (SCA). In this respect, the Government and the two power companies will have discussions during the annual Tariff Review in the preceding year. In the course of which, apart from capital expenditure, the latest available data as regards electricity demand and sales, operating costs, fuel prices, measures to control cost and increase productivity, balances in the Fuel Clause Account and Development Fund, affordability of the consumers and permitted return, etc. will also be taken into account.

Q4. CLP's Development Fund balance would decrease in the Financial Plan period and is projected to be substantially below the Development Fund cap agreed during the 2003 Interim Review by end September 2008. With decreasing balances, there would be no surplus DF to finance CLP's capital expenditure programme in the Financial Plan period. Why would the fund balance decrease? What are the details?

A4. The purpose of the Development Fund (DF) is to provide a depository for net revenue in excess of the permitted return, for providing funding for acquisition of fixed assets. The DF also provides funds, when necessary, to ameliorate the impact of tariff increase. During the Financial Plan period, capital expenditure by CLP to ensure reliable safe supply and to minimize environmental impact will have pressure on the tariff. The DF will be deployed to stabilize tariff.

- Q5. According to the proposals of the two power companies, for the purposes of reducing atmospheric emissions of sulphur dioxide (SO₂) and nitrogen oxides (NO_x), HEC will retrofit two coal-fired units with Low NO_x Burner and Flue Gas Desulphurization (FGD) plant, while CLP will retrofit four coal-fired generating units with FGD plant and Selective Catalytic Reduction plant. However, both companies will pass on the costs for these projects as capital expenditure to the customers. Why are the shareholders of both companies not required to bear part of these costs?
- A5. Pursuant to the Scheme of Control Agreement (SCA), expenses arising from electricity-related development projects could be counted as capital expenditures. The emission reduction projects of the two power companies are launched in pursuance of the Government's policy to achieve the air-quality objectives as soon as practicable. These projects could therefore be counted as capital expenditures under the SCA.
- Q6. Both power companies have neither put forward proposals to reduce respirable suspended particulates emissions, nor plans for the development of renewable energy in their Financial Plans, so as to improve the air quality in Hong Kong. Why does the Government agree to their proposals?
- A6. The Government supports the emission reduction projects in the Financial Plans of the two power companies as they help to reduce air pollutants and facilitate meeting the emission reduction targets needed for improving the air quality in Hong Kong and the Pearl River Delta Region. The Government's consultant also consider the proposed projects to be the most viable and cost-effective option for reducing sulphur dioxide (SO₂) and nitrogen oxides (NO_x) emissions, among other alternatives.

The two power companies' projects are not sufficient for achieving the emission reduction targets needed for improving the air quality in Hong Kong and the Pearl River Delta Region and the emission caps in 2010. They would need to take additional measures to ensure meeting the intended emission caps for 2010 and beyond, if they were to continue to meet in whole or in part the demand for electricity after 2008. In this connection, EPD will impose,

pursuant to the Air Pollution Control Ordinance, emission caps in the relevant Specified Process Licences with a view to reducing the emissions by the two companies to the practical minimum.

For the purpose of enhancing reliability, we support the use of different fuels, including renewable energy, for power generation. The two power companies will decide on their fuel mix, taking into account the supply reliability and cost-effectiveness of different types of fuel.

In considering the arrangement for the electricity market after 2008, we will examine the role of renewable energy in meeting Hong Kong's Sustainable Development Strategic objective.